IDEAS ON LIBERTY

- The Colonial Origins of American Liberty
- The Miracle of Privatization
- Economists Against the FDA
- Who's to Blame?

SEPTEMBER 2000

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THE CLASSIC BLUEPRINT FOR A JUST SOCIETY

THE LAW

BY FREDERIC BASTIAT

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WALTER E. WILLIAMS
Foreword by
SHELDON RICHMAN

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IDEAS ON LIBERTY

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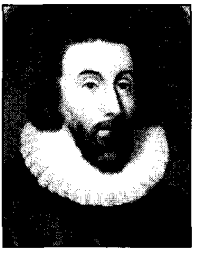

John Winthrop

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PERSPECTIVE

Who's to Blame?

Advocates of liberty are frequently confronted with the following fallback position of their intellectual adversaries: We live in a representative democracy. If you don't like what is taking place, your beef is with the people who have freely chosen their representatives.

That argument is intended to blunt criticism of activist government. If the people have freely chosen it, who are you to complain?

There are several problems with that argument. First, the United States was supposed to be a constitutional republic, not a democracy. A constitution is intended to limit the people's power to use the government to achieve their ends. As the framers saw it, the delegation of enumerated powers to the Congress means that, barring amendment, that's all the Congress can do—no matter how badly "the people" want something else done. Unfortunately, the delegated powers have been stretched beyond recognition to permit Congress to define its own powers.

Appealing to the representative nature of the government has further problems. If those representatives and the bureaucrats they empower deliberately shroud their activities so that citizens find it virtually impossible to monitor the government, how representative is it really? Someone of statist mindset might invoke the division of labor: Citizens, the argument might go, delegate decision-making power to specialists in public policy by electing the president and members of the legislature. That's what the civics textbooks say, at any rate. But the real world doesn't quite conform.

The latest evidence comes in a startling confession by Senator Daniel Patrick Moynihan. In June Moynihan wrote about Social Security in the *New York Times*. To provide some context, he turned back to 1977, when Congress changed the method for financing the program. "In 1977," he wrote, "Social Security, the retirement program, was changed from a pay-as-you-go system to a partially funded system." To accomplish this the government hiked the payroll tax two points. Now instead of having only the amount required to pay the retirees, the sys-

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tem had a surplus with which to build a reserve fund. It wasn't a real reserve fund, because the government spent the money. But Social Security got IOU's, which someday the government will pay—by raising taxes or borrowing.

What's relevant about that legislative history is this comment from Moynihan: "No one noticed this [change]. I was a member of the 1977 House-Senate Conference Committee that enacted the law, and I surely didn't notice. Nor was it reported."

Bear in mind that Moynihan is considered one of the most intelligent and conscientious members of Congress. (He's George Will's favorite senator.) *But he didn't notice the change!* Moreover, it was not reported, meaning the public wasn't informed. (So much for the crack Washington press corps.)

The lesson: We have a government that essentially defines its own powers and in which its officials—much less the people—often don't know what's going on. Time to rewrite the civics texts.

* * *

Odd things can happen when public property turns into private property. For example, it can become more accessible to the public than when it was "public." John Blundell resolves the paradox.

The essence of the freedom philosophy is that without private property there is no liberty. Even the seemingly propertyless, writes James Bovard, are protected by this depreciated institution.

Nearly every economist who has studied the matter closely agrees that the Food and Drug Administration harms consumers and should be eliminated sooner or later. Daniel Klein elaborates the reasons for this remarkable unanimity.

Trade with China may accelerate economic and political liberalization there. Then again, it may not. Nevertheless, the barriers should come down, writes Christopher Lingle.

The Founding Fathers, as admirable as they are, sometimes get too much credit. After all, Thomas Woods says, they were heirs to a uniquely formative colonial experience.

New Zealand's bold venture in voluntary unionism, alas, has come to an end. Charles Baird writes the not-quite-an-obituary.

Last year Richard Timberlake wrote a three-part series in these pages on the Federal Reserve's monetary policies before and during the Great Depression. Then Joseph Salerno critiqued Timberlake's thesis from the framework of Austrian economics. In a final go-around, Timberlake and Salerno rebut each other and argue for their respective positions.

Here's what our columnists have come up with this month: Donald Boudreaux makes the case for true self-government. Lawrence Reed draws attention to continuing farm socialism. Doug Bandow assays the implications of Medicare's expansion into prescription medicines. Thomas Szasz wonders why anyone's amazed that some pharmacies don't stock certain painkillers. Dwight Lee applies marginal analysis to labor. Mark Skousen warns: beware easy money. Russell Roberts isn't convinced that campaign finance control will set us free. And Karen Palasek, hearing arguments for government to address a wage gap detrimental to women with children, responds, "It Just Ain't So!"

This month's book reviewers size up volumes on private education initiatives around the world, the bloody twentieth century, the cost of eliminating the welfare state, property, false knowledge, and James Madison.

—SHELDON RICHMAN

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Thoughts on Freedom

by Donald J. Boudreaux

Self-Government

The United States is often described as an experiment in self-government. But what is this thing? Most people understand "self-government" to mean democracy. According to this understanding, a people are self-governed if they regularly vote to select the individuals who are to occupy political offices. This method of deciding who holds political power has clear advantages over conferring political power according to military prowess, bloodlines, or other criteria remote from the input of the ordinary men and women who are to be governed.

Understood in this way, to endorse self-government is hardly to take a courageous or controversial stand. No good case can be made that fitness to govern is best determined by bloodline or by skill at military conquest. Clearly, whatever power the state exercises ought to be exercised by people chosen in fair elections by those who are subject to the state's dictates. Almost no one in modern Western society disagrees that people ought to be governed in this way.

But such government, regardless of its merits, is not *really* self-government. It is government by the elected. No amount of romantic praise of democracy can change the fact that even the best popularly elected government routinely obliges Smith—against his will—to do the bidding of Jones. And whether Jones be an influential special-interest group or a popular majority, when Smith is threatened with coercion to do Jones's bidding, neither Smith nor Jones is self-governing. Smith is governed by Jones, and Jones is governing not only himself but Smith as well.

True Self-Government

Self-government in a truer, more literal sense is both desirable and possible.

True self-government is just that: *self*-government. Each individual governs himself. Each person is free to chart his own life's course, choosing which risks to brave and which to avoid. Each person is responsible only for himself, for his family, and for those whom he—of his own volition—chooses to care for. Each person has a claim to the fruits only of his own labor and sacrifices, and no claim to the fruits of another's labor and sacrifices. Each person has a legal right to do as he wills so long as he respects the equal rights of others and honors all his commitments.

Of course, living in this way—as a free man or woman— requires discipline. To be foolish and imprudent is to fail at self-government. Typically, people who don't govern themselves personally pay the price of not doing so. One advantage of a free society is that it focuses the costs of irresponsible behavior on those who behave irresponsibly, and it focuses the benefits of responsible behavior on those who behave responsibly. The result is that irresponsible behavior is kept to a minimum.

But how to distinguish responsible from irresponsible behavior? If we let each individual determine how to make this distinction, won't the result be chaos?

Donald Boudreaux is president of FEE.

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Some behaviors are plainly and always destructive of social cooperation. Murder, theft, rape, slaveholding, arson—these and other behaviors whereby some people coerce others are unquestionably out of bounds; the law should prohibit them. These behaviors should be prohibited precisely because they interfere with their victims' rights to govern themselves.

The precise means of deciding which behaviors the law should prohibit, as well as how to enforce these prohibitions, is debatable. I don't wish to weigh in here on the dispute between anarcho-capitalists and advocates of limited government. Reasonable people can and do disagree about just how far we can go in ridding ourselves of the state, although no reasonable person believes that society can exist without *laws* protecting each of us against coercive threats against our persons and property.

But the state today does far more than enforce laws against murder, theft, and other obviously predatory acts. Almost all that today's state does offends the idea of self-government. Government in America today doesn't hesitate to coerce those who are politically weak to do the bidding of those who are politically strong. Nor does government today hesitate to treat its subjects as foolhardy imbeciles in need of strict guidance from the state. In both ways, today's government denies people their right of self-government. The state governs; its subjects obey. Each of us is ruled to an increasingly large degree not by ourselves, but by others.

Consider: regulations mandating that we wear seat belts; minimum-wage legislation; government restrictions on drug use; state blue laws; truancy statutes; the regulation of advertising; tariffs and other import restrictions; government controls on which foreigners we may associate with on American soil; building codes; occupational licensing; the command that every worker contribute to the Social Security and Medicare schemes; taxation that consumes around 40 percent of our income—the list of offenses against self-government is endless.

Many people who reflect on all that government does today will insist that it simply *must* do these things, for otherwise, too many people will fall into traps that they are either too stupid or too weak to avoid.

I don't doubt that each of us will make some choices that we later regret. Nor do I doubt that some of us will prove to be especially inept at making wise choices. And surely from time to time these unwise choices will lead to terrible consequences.

But what is self-government if not the ability to govern yourself as *you* choose—with *you* taking responsibility for yourself and leaving others free to take responsibility for themselves? Those who insist that government must take responsibility for the safety and welfare of people should stop proclaiming their allegiance to liberty and self-government. They should instead forthrightly proclaim an allegiance to the principle of government by the elite few of the irresponsible many.

I would resolutely object to this principle, but at least its advocates would be forthright. They would no longer be masquerading as friends of the noble ideals that motivated Jefferson and Madison. They would, instead, honestly reveal themselves as patrons of the notion that ordinary men and women are incapable of self-government and, hence, unworthy of liberty. The result would be a more enlightening debate. Liberty and self-government stand clearly opposed to the exercise of intrusive state authority. People advocating intrusive state authority would then be explicitly aware that they reject liberty. They would be forced to concede that they do not believe in the principle of self-government. □

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IDEAS ON LIBERTY
SEPTEMBER 2000

Female-Parent Wage Gap Requires Action?

It Just Ain't So!

Sylvia Ann Hewlett's *New York Times* article, "Have a Child, and Experience the Wage Gap" (May 16, 2000), presents itself as a summary of the detrimental effect that the choice to have children imposes on women's wages. The author leads her readers through seemingly relevant data contrasting the dollar incomes of double-earner families with the price (exclusive of college tuition) of bringing children along to the age of 18.

We are told we must not forget the *hidden costs* of child-rearing, particularly for the mother. As if it isn't bad enough that there already exists a gap between men's and women's wages, this children/no-children difference adds insult to injury. Even among women, those without children do better than those with kids, and the gap gets worse with each child. Conclusion: the policy Band-Aids that have been offered to working female parents are a welcome but pitifully inadequate remedy for the double disadvantage under which they struggle. The Clinton administration's executive order banning discrimination in the federal workplace against working parents, according to the author, doesn't go nearly far enough. Ms. Hewlett cites the work of economist Jane Waldfogel to lend authority to her argument for regulation of private-sector hiring of parents as well.

On the surface, Ms. Hewlett appears to be making a cogent argument. Assuming that the data are accurate, we are made vividly aware of the uneven wages among men, women, and women parents. As "hidden costs" Hewlett counts the difference between wages actually earned by women parents and those of their non-parent female counterparts. It isn't clear whether Hewlett thinks that lack of paid leave, too-expensive daycare, and inflexible work hours are also "hidden costs," or are just another target on her general list of gripes.

Child-rearing certainly involves hidden costs for women; these are better known to economists as opportunity costs. Discussing them intelligently requires understanding how they arise. They do so whenever we make choices: alternative courses of action have unique consequences. When we choose path A rather than path B, we get the consequences pursuant to path A, while the consequences associated with path B never come into existence. If we women choose to raise families, it is presumed that we get the consequences associated with that choice: large and somewhat unpredictable monetary obligations over an extended period (as opposed to paying off an automobile with a set price in a few years), significant and unpredictable demands on our time, and what Ms. Hewlett calls "hidden costs," which are really path-dependent alternative consequences, that is, higher earnings, that fail to materialize.

To the extent that the "reduced" earnings Ms. Hewlett describes are the result of the normal time and money demands of raising children per se, they are not hidden at all, though they may be variable. They are simply theoretically higher earnings that never appear. That the ordinary obligations of child-rearing cut into the available time and attention that mothers have to devote to another job, and that the consequences of combining these choices reduces either the returns to the mother or the returns to the children, is perfectly logical. Who could reasonably expect to get the full results of being exclusively a mother or exclusively a career woman while in reality spending only part-time in at least one of these pursuits? *That the choices we make do not give us the results of the choices we do not make should be no surprise.*

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The Effects of Policy

Ms. Hewlett, as an advocate for working mothers, confronts us with the low-earnings/high-cost theme over and over by scattering large quantities of unrelated data throughout her article. By the end of her piece, we are left with a collection of gripes and data on the responsibilities of child-rearing that by sheer volume must, I suppose, convince us that policy action is imperative. Do we really need a policy because, as the author alleges, kids expect preschool, braces, therapy, summer camp, and computer equipment? And do parents really need to be rescued by the state because they are rewarded for their sacrifices with mere hugs and kisses, while "the nation" allegedly gets all the real benefits? I suspect that what we really need is more mature adults—understanding that families can involve materially uncompensated sacrifices and tradeoffs.

As a corollary to the principle of hidden opportunity costs, we must pay attention to the effects of government policy choice on everyone in the community, not just on one group. Regardless of what we would like to believe or how we would prefer the world to operate, secondary and unintended consequences, sometimes long-run consequences, extend beyond working mothers. At the family level, the choices made by mothers impose some consequences on their children, whether the mothers work or stay at home. The author addresses only the mother's opportunity costs and returns, ignoring those to the children.

At the national level, the author misses the opportunity-costs boat altogether. Exactly whose taxes should be increased to achieve the income parity with non-parenting women or men that Sylvia Hewlett would like to see achieved? It's a sure bet that she doesn't advocate wage parity via wage reductions for everyone else. Even regulating the private employer in the way she suggests will not affect most of the items on her list, like the high cost of braces and the lack of satisfaction parents get with "intangible rewards" of hugs and kisses. Whose wants and desires should we curtail by reducing their opportunities with higher taxes and regulations so that working moms can "have it all"?

Though steeped in data, it is important to recognize that "Have a Child, Experience the Wage Gap" presents merely the author's value judgments dressed up like an economic calculation problem. Our values, not statistical evidence of some income disparity, should determine our policies. And knowing that more favorable legislation will make working moms better off doesn't automatically justify changing a large number of third parties' opportunity costs. The power of economic tools is in their ability to enlighten us. When misused as window dressing, or as substitutes for a forthright discussion of values and preferences, they serve only to confuse and misdirect.

—Karen Palasek
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SEPTEMBER 2000

The Miracle of Privatization

by John Blundell

When I was a small boy I used to bicycle in the hills of northwest England where Derbyshire and Cheshire meet. In the distance I could often see glimpses of water, but all roads to it were blocked by locked gates and signs reading "Public Property: Keep Out."

Today, following the privatization of the water industry, the roads are open and the signs read "Private Property: Public Welcome." Driving in now, one sees the wonderful views, the walks, the garden, the nature center, the restaurant, the large playground, the picnic sites, and the parking lots. There is also a regular bus service to neighboring towns.

What a transformation and what a symbol of the power of privatization!

When it was "public" it was very private. Indeed, it was totally captured by a small band of bureaucrats. Even members of Parliament struggled to find out what was going on. No proper accounts were produced, and with a complete lack of market signals, managers were clueless as to the correct course to take. The greatest casualty was a lack of long-term capital investment.

Now it is "private" and very public. Not just public in the sense of open, but also in the sense of accountable directly to its shareholders and customers. Copious reports and accounts are available and questioning citizens will find their concerns taken very seriously indeed.

John Blundell is general director of the Institute of Economic Affairs in London.

Privatization has totally transformed the British economy. Ports, airports, coal, gas, BP, steel, sugar, telecomms, electricity, forests, shipbuilding, motorway restaurants, freight, nuclear power, Rolls Royce, Rover, Royal Ordnance, Short Bros., and water: all have been privatized to the long-term benefit of all concerned, be they customers, shareholders, taxpayers, or all three. And not just for British people. The leaders of these newly privatized industries have become so good at what they do so fast that they are now doing it all over the world.

So many books have been written on the privatization process and its benefits they fill a stack in the library. Indeed my own institute, the Institute of Economic Affairs, publishes an annual book of lectures on post-privatization utility regulation. But in general terms, let me set out Blundell's Ten Laws of Privatization, that is to say, the ten most common effects of moving ownership and management from state hands to private hands.

Blundell's Ten Laws of Privatization

1. Lower prices. Competition and the rooting out of bureaucratic practices inevitably lead to lower prices. Domestic gas consumers have, for example, seen their bills cut by £1 billion since competition was introduced.

2. Better quality. Anybody using a British phone today knows the connection is faster,

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clearer, and more reliable—as well as being cheaper.

3. More choice. The UK is now the only country in the world where even the smallest household consumer can choose between competing natural gas *and* electricity suppliers.

4. Less corruption. Twenty years ago there was a three-month waiting list for a phone and a 50-pound bribe (200 pounds or $350 at today's price levels) was needed to get to the top of the list—today you choose the time when they come to serve you!

5. More investment. Once privatized, a long-term view could be taken rather than the annual trip to see the government minister. Telecomms in particular have benefited.

6. More innovation. We used to have two choices of phones: white or black! Now whole shops stocking an incredible variety of equipment are a common sight.

7. Better management. The electricity generators have halved their costs since privatization. There has been a real influx of private-sector management.

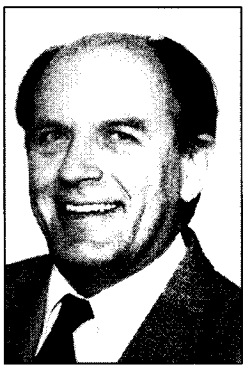
8. More openness. Accounts are published, journalists can investigate, citizens get their questions answered, and we all have a far greater knowledge of what is actually happening.

9. Better measures. Firms are now judged by the market, and the managers are free to set goals. In the past they were judged and manipulated by politicians, and the managers often found themselves setting political goals such as creating jobs in a marginal area.

10. Fewer strikes. These industries (particularly coal, electricity, and railways) were vulnerable to strikes, which have now all but disappeared. Indeed 80 percent of all days lost to strikes today occur in the Post Office, which was not privatized!

So, if you want more innovative, less corrupt, better managed firms that are more open, employ better measures, are less strike prone, and invest more for the future to bring you more choice and better quality at lower prices, then it's easy: go for privatization. It works! □

Foundation for Economic Education Fall Dinner



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Dr. Charles Murray

Author of *Losing Ground* and *What It Means to Be a Libertarian*

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IDEAS ON LIBERTY
SEPTEMBER 2000

Property and Liberty

by James Bovard

Property is "the guardian of all other rights," as Arthur Lee of Virginia wrote in 1775.[1] The Supreme Court declared in 1897: "In a free government almost all other rights would become worthless if the government possessed power over the private fortune of every citizen."[2] Unfortunately, legislators, judges, and political philosophers in the twentieth century have perennially disparaged property's value to freedom.

Without private property, there is no escape from state power. Property rights are the border guards around an individual's life that deter political invasions. Those who disparage property often oppose any meaningful limits on government power. John Dewey, for instance, derided "the sanctity of private property" for providing "freedom from social control."[3] Socialist regimes despise property because it limits the power of the state to regiment the lives of the people. A 1975 study, *The Soviet Image of Utopia*, observed, "The closely knit communities of communism will be able to locate the anti-social individual without difficulty because he will not be able to 'shut the door of his apartment' and retreat to an area of his life that is 'strictly private.'"[4] Hungarian economist Janos Kornai observed: "The further elimination of private ownership is taken, the more consistently can full subjection be imposed."[5]

James Bovard is the author of Freedom in Chains: The Rise of the State and the Demise of the Citizen *(St. Martin's Press).*

Yet Oxford professor John Gray asserted in 1990 that "very extensive State intervention in the economy has nowhere resulted in the extinction of basic personal and political liberties."[6] One wonders which freedoms Bulgarian and Romanian citizens enjoyed under communism that Gray neglects to mention. Perpetual shortages of almost all goods characterized East Bloc economies; politicians and bureaucrats maximized their power and maximized people's subjugation through discretionary doling out of goods. Shortages created new pretexts to demand further submission: the worse the economic system functioned, the more power government acquired—until the people rose up and destroyed the governments.[7]

The Economy Is Lives

Government cannot control the economy without controlling the lives of everyone who must rely on that economy to earn his sustenance. There is more to life than wealth. But the more wealth government seizes from people, the more likely that government will be able to control all the other good things in life. Once government domineers the economy, it becomes far more difficult to resist the extension of government power further and further into the recesses of each person's life.

Property rights are not concerned merely with the sanctity of the estates of the rich. The property right that each citizen has in himself is the foundation of a free society. As James

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Madison observed, "Government is instituted to protect property of every sort; as well that which lies in the various rights of individuals, as that which the term particularly expresses."[8] The property that each citizen has in his rights is the foundation of his ability to control his own life and strive to shape his own destiny.

Some contemporary liberals argue that government ownership is the ultimate safeguard of freedom. According to Alan Wolfe, "No one would be able to enjoy the negative liberty of walking alone in the wilderness if it were not for the regulatory capacity of government to protect the wilderness against development."[9] Wolfe implies that if the government did not own much of the nation's land, private citizens would ravage the landscape from coast to coast. However, private landowners have a better record of safeguarding the environmental quality of their land than does the federal government.[10] The Army Corps of Engineers has destroyed far more of the natural river beauty in this country than has any private malefactor, and the Federal Emergency Management Agency's lavish subsidies for "flood insurance" have made possible vast numbers of buildings on ecologically fragile coastlines.[11] Wolfe also implies that no private forest owner would permit anyone else to walk on his land. However, the proliferation of contracts for hunting on private land show that, with a sound incentive system, access to private land can easily be negotiated. Citizens have different values, and many citizens prefer to keep their land in semi-pristine condition. Besides, even if all citizens wanted to sell their land to developers, only a small percentage of such land would be developed—simply because there is no economic rationale for developing much of rural America.

Bulwark of Privacy

The sanctity of private property is the most important bulwark of privacy. University of Chicago law professor Richard Epstein wrote that "private property gives the right to exclude others *without* the need for any justification. Indeed, it is the ability to act at will and without need for justification within some domain which is the essence of freedom, be it of speech or of property."[12] Unfortunately, federal law enforcement agents and prosecutors are making private property much less private. In 1984 the Supreme Court ruled in *Oliver v. United States*—a case involving Kentucky law-enforcement agents who ignored several "No Trespassing" signs, climbed over a fence, tramped a mile and a half onto a person's land and found marijuana plants—that "open fields do not provide the setting for those intimate activities that the [Fourth] Amendment is intended to shelter from government interference or surveillance."[13] (The Founding Fathers apparently forgot to include a parenthesis in the original Fourth Amendment specifying that it applied only to "intimate activities.") And the Court made it clear that it was not referring only to open fields: "A thickly wooded area nonetheless may be an open field as that term is used in construing the Fourth Amendment."[14] Justice Thurgood Marshall dissented: "Many landowners like to take solitary walks on their property, confident that they will not be confronted in their rambles by strangers or policemen."[15] Even prior to this ruling, it was easy for law-enforcement agents to secure warrants to search private land merely by concocting an imaginary confidential informant who told police about some malfeasance.[16]

The core of the "open fields" decision is that the government cannot wrongfully invade a person's land, because government agents have a right to go wherever they damn well please. After this decision, any "field" not surrounded by a 20-foot-high concrete fence is considered "open" for inspection by government agents. (And for those areas that are sufficiently fenced in, the Supreme Court has blessed low-level helicopter flights to search for any illicit plants on the ground.[17])

The Supreme Court decision, which has been cited in over 600 subsequent federal and state court decisions, nullified hundreds of years of common-law precedents limiting the power of government agents. The ruling was a green light for warrantless raids by federal immigration agents; in late 1997 the *New York Times* reported cases of upstate New York

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farmers' complaining that "immigration agents plowed into fields and barged into packing sheds like gang busters, handcuffing all workers who might be Hispanic and asking questions later. . . . [D]oors were knocked down, and workers were wrestled to the ground."[18] In a raid outside of Elba, New York, at least one INS agent opened fire on fleeing farm workers.[19] Many harvests subsequently rotted in the fields because of the shortage of farm workers.

Conflicting Views of Freedom

The "open fields" doctrine provides an acid test of conflicting views on freedom. Are people more or less free when government agents can roam their land? Are they more or less free when they can be accosted by government agents any time they step past the shadow of their front door? Is freedom the result of government intrusions—or of restrictions on intruders? The scant controversy the 1984 decision evoked is itself a sign of how statist contemporary American thinking has become.

Few government policies better symbolize the contempt for property rights than the rising number of no-knock raids. "A man's home is his castle" has been an accepted rule of English common law since the early 1600s and required law-enforcement officials to knock on the door and announce themselves before entering a private home. But this standard has increasingly been rejected in favor of another ancient rule—"the king's keys unlock all doors."[20]

A *New York Times* piece observed in 1998 that "interviews with police officials, prosecutors, judges and lawyers paint a picture of a system in which police officers feel pressured to conduct more raids, tips from confidential informers are increasingly difficult to verify and judges spend less time examining the increasing number of applications for search warrants before signing them."[21] The *Times* noted that "the word of a single criminal, who is often paid for his information, can be enough to send armed police officers to break down doors and invade the homes of innocent people."[22]

No-knock raids have become so common that thieves in some places routinely kick down doors and claim to be policemen.[23] The Clinton administration, in a 1997 brief to the Supreme Court urging blind trust in the discretion of police, declared that "it is ordinarily reasonable for police officers to dispense with a pre-entry knock and announcement."[24] Law-enforcement agencies' fear of losing small amounts of drug evidence has fueled attacks on the sanctity of homes. The Clinton administration, for instance, appears far more concerned about the flushing of drugs than about the flushing of privacy. In a 1995 brief to the Supreme Court, the Clinton administration stressed that "various indoor plumbing facilities . . . did not exist" at the time the common law "knock-and-announce" rule was adopted.[25] Making a grand concession to civil liberties, the administration admitted that "if the officers knew that . . . the premises contain no plumbing facilities . . . then invocation of a destruction-of-evidence justification for an unannounced entry would be unreasonable."[26] The Supreme Court has failed to impose effective restraints on police's prerogative to carry out no-knock raids. Professor Craig Hemmens observed that the Court's "recent decisions involving the knock and announce rule, essentially gutted the rule, reducing it to little more than a 'form of words.'"[27]

Police also possess the right to destroy property they search. Santa Clara, California, police served search and arrest warrants by firing smoke grenades, tear-gas canisters, and flash grenades into a rental home; not surprisingly, the house caught fire and burned down. When the homeowner sued for damages, a federal court rejected his plea, declaring that the police "only . . . carelessly conducted its routine and regular duty of pursuing criminals and obtaining evidence of criminal activity. The damage resulted from a single, isolated incident of alleged negligence."[28]

It is as much a violation of property rights and liberty when government agents storm into the shabbiest of rental apartments as when they invade the richest mansion. The sanctity acquired by renters to a private domain illustrates how the exchange of private property can give someone vested rights—rights within which they can build

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and live their own lives. Local and state governments routinely treat renters as second-class citizens; many localities have mandatory inspection policies for all rental units that permit government officials to search private dwellings without a warrant or any pretext. Park Forest, Illinois, in 1994 enacted an ordinance that authorizes warrantless searches of every single-family rental home by a city inspector and police officer, who are authorized to invade rental units "at all reasonable times." No limit was placed on the power of the inspectors to search through people's homes, and tenants were prohibited from denying entry to government agents. Federal Judge Joan Gottschall struck down the searches as unconstitutional in February 1998, but her decision will have little or no effect on the numerous other localities that authorize similar invasions of privacy.[29]

Bane of Freedom?

Some socialists have argued that private property is a bane of freedom because inequality of wealth is equivalent to political tyranny. According to historian R. H. Tawney, "Oppression . . . is not less oppressive when its strength is derived from superior wealth, than when it relies on a preponderance of physical force."[30] But regardless of how much wealth a person owns, he has no legal right to coerce other citizens. Offering someone the best wage he can find is unlike holding a gun to his head; offering someone the best price for a product he is selling is not like expropriation. A legitimate government must restrict the coercion of all citizens, including those with the largest bank accounts. But the fact that politicians are sometimes corrupted by bribes and deny equal protection of the law to the poor is not a good reason to give more power to politicians.

To understand the difference between economic wealth and political power, consider the difference between the power of a boss and that of a government agent. Any power that a boss or company has over a person is based on a contract, express or implied; that power is limited to the work and time contracted for. (Contracts for lifetime labor are illegal in the United States.) A boss's power is conditional, dependent on an employee's choosing to continue to receive a paycheck.

In contrast, the government agent's power is often close to absolute: for example, a citizen who refuses to pull over for a traffic cop flashing his lights can face jail time, regardless of whether the cop had a legitimate reason to stop him. Markets allow people a choice of whom to deal with, while government dictates that citizens must submit to its orders. As Nobel laureate James Buchanan observed, "As individuals become increasingly dependent on 'the market,' they become correspondingly less dependent on any identifiable person or group. In political action, by contrast, increasing dependence necessarily becomes increasing subjection to the authority of others."[31] Markets limit the power of people to dictate to other people because the parties can seek other bidders or sellers. Markets provide venues for people to voluntarily agree with other people. Markets are symbolic of voluntary activities in the same way that jails are symbolic of coercion.

Some friends of government legitimize vesting sweeping power in politicians by defining practically any private business decision as coercive. Economist Robert Kuttner declared on a 1997 PBS program that "when a company relocates overseas . . . that is a form of violence."[32] To define practically any economic change as "violence" is to authorize an unlimited number of political first strikes against property owners. If moving a factory overseas is a form of violence, then moving a factory across state lines is also a form of violence—since the "violence" is presumably done by a factory leaving one location, regardless of where it relocates. When a person is given a "right" to a job, all other people are prohibited from competing for that job.

A viable concept of freedom must consist of more than psychological wish fulfillment —more than a fantasy world in which every citizen can buy low and sell high, in which every citizen gets the wages he demands and pays the prices he pleases. It is crucial to distinguish between frustrated economic aspirations and government coercion. Feeling a compulsive need to impress neighbors by

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buying a swimming pool is not the same as facing arrest for planting grass seed in your yard and allegedly disturbing a federally designated wetland. The compulsion to buy a suit of the latest fashion is not the same compulsion as experienced during an IRS audit, especially if the agent decides to employ a notorious "lifestyle audit," which forces citizens to detail and justify how much cash they had on hand at any one time a year or two before, whether they have a safe deposit box and what it contains, how much they spend on groceries, where they eat out, what toys they buy for their children, and what books or jewelry they purchase.[33] The compulsion to buy a new car differs from the compulsion you feel when police pull you over, announce that your appearance matches that of a "drug courier profile," and proceed to rummage through your trunk, glove compartment, tire hubs, and pockets, and to ask a bevy of incriminating questions about your personal life.[34] The fact that a person spends himself deeply into debt and thus feels obliged to keep working at a job he despises is not coercive because no one compelled the person to become a mindless consumer.

An inability to find a satisfactory job or satisfactory career path is not a violation of liberty—unless government or private action forcibly blocks or restrains people. A person is not "oppressed" by his own lack of marketable job skills: every art history major who did not find a good job after college is not a victim of some sinister force.

One of the clearest violations of freedom of contract is government licensing laws, which prohibit millions of Americans from practicing the occupation of their choice. Over 800 professions, from barbers to masseuses to interior designers to phrenologists to tattooists to talent agents, now require a government license to practice. Licensing laws are usually engineered by professional associations that want to "protect" the public from competitors who might charge lower prices.[35] Licensing laws kept many blacks out of the skilled professions until the civil rights era. The Federal Trade Commission perennially reports on the anticompetitive aspects of state government licensing boards.[36] For many professions, private accreditation systems—many of which have already been developed—would provide a much more reliable consumer guide than politically controlled certification systems.

Liberty in Action

Property is the basis of freedom of contract, which is simply liberty in action. Without freedom to exchange, government places all exchanges at the discretion of the political-bureaucratic ruling class. As new forms of property and wealth have developed in the last 200 years, it is now much clearer how vital property is to all citizens' freedom, not merely that of landowners. By holding title to certain resources (including themselves and their own labor), people can make exchanges with others that allow them to raise themselves, to better provide for their families, to pursue their own values. Freedom is more than the right to own property or the right to buy and sell. But once the citizen loses the right to own—even if he previously owned nothing—he loses the ability to control his own life. If the citizen is denied the right to own or control his own computer disks or the clothes on his back, he has little chance of being able to shape his own future.

Property rights and market economies are vital steppingstones to political freedom. Private property gives people a place to stand if they must resist the government. Market economies and private property allow citizens to build up sufficient wealth to resist government pressure.

It is important to have freedom to buy and sell, to invest, to innovate, to choose one's risks and reap one's profits—but it is not enough. It is also vital that police not be able to break people's heads, or entrap them on bogus charges, or intercept their e-mail at a whim, or target them because of their race, ethnicity, or political ideas. Unfortunately, some advocates of economic freedom seem nonchalant about practically any use of government power that does not directly interfere with profit-making. □

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3. John Dewey, *Liberalism and Social Action* (New York: G. P. Putnam's Sons, 1935), p. 34.

4. Jerome Gilison, *The Soviet Image of Utopia* (Baltimore: Johns Hopkins University Press, 1975), p. 149.

5. Quoted in Robert Skidelsky, *The Road from Serfdom* (New York: Penguin, 1997), p. 99.

6. Ibid., p. 119.

7. James Bovard, "Eastern Europe, The New Third World," *New York Times*, December 20, 1987, and James Bovard, "The Hungarian Miracle," *Journal of Economic Growth*, January 1987.

8. *The Writings of James Madison*, vol. 6, ed. Gaillard Hunt (New York: G.P. Putnam's Sons, 1906), p. 103. The quote is from an article Madison wrote for the *National Gazette*, March 29, 1792.

9. Alan Wolfe, review of Stephen Holmes's *Passions & Constraint: On the Theory of Liberal Democracy*, *New Republic*, May 1, 1995.

10. Tom Bethell, *The Noblest Triumph: Property and Prosperity Through the Ages* (New York: St. Martin's Press, 1998), pp. 272–89.

11. James Bovard, "Assistance to Flood Victims Invites Further Disaster," *Los Angeles Times*, June 18, 1997.

12. Richard Epstein, *Takings* (Cambridge, Mass.: Harvard University Press, 1985), p. 66.

13. *Oliver v. United States*, 466 U.S. 170, 179 (1984).

14. Ibid., p. 180, fn. 11.

15. Ibid., p. 192.

16. *The National Law Journal* reported in 1995 that between 1980 and 1993 the number of federal search warrants relying exclusively on confidential informants nearly tripled, from 24 percent to 71 percent, and that "from Atlanta to Boston, from Houston to Miami to Los Angeles, dozens of criminal cases have been dismissed after judges determined that the informants cited in affidavits were fictional." Mark Curriden, "Secret Threat to Justice," *National Law Journal*, February 20, 1995.

17. *Florida v. Riley*, 488 U.S. 445 (1989).

18. Evelyn Nieves, "I.N.S. Raid Reaps Many, But Sows Pain," *New York Times*, November 20, 1997.

19. Associated Press, "Agent Fired During Raid on Migrants, Report Finds," *New York Times*, December 12, 1997.

20. Craig Hemmens, "I Hear You Knocking: The Supreme Court Revisits the Knock and Announce Rule," *University of Missouri at Kansas City Law Review*, Spring 1998, p. 562.

21. Michael Cooper, "As Number of Police Raids Increase, So Do Questions," *New York Times*, May 26, 1998.

22. Ibid.

23. Barney Rock, "Kicking in Doors New Trend among Thieves," *Arkansas Democratic Gazette*, January 21, 1995.

24. Hemmens, p. 584.

25. Brief for the United States as Amicus Curiae Supporting Respondent, *Wilson v. Arkansas*, no. 94-5707, February 23, 1995, p. 26.

26. Ibid., p. 28.

27. Hemmens, p. 601.

28. *Patel v. U.S.*, 823 F. Supp. 696, 698 (1993). For discussion of this case, see Gideon Kanner, "What Is a Taking of Property?" *Just Compensation*, December 1993.

29. *Kenneth Black et. al v. Village of Park Forest*, 1998 U.S. Dist. LEXIS 2427, February 23, 1998.

30. Quoted in Robert E. Goodin, *Reasons for Welfare* (Princeton, N.J.: Princeton University Press, 1988), p. 307.

31. James Buchanan, "Divided We Stand," review of *Democracy's Discontent: America in Search of a Public Philosophy*" by Michael J. Sandel, *Reason*, February 1997, p. 59.

32. "Debate on Free Trade," Public Broadcasting Service, August 15, 1997.

33. Arthur Fredheim, "IRS Audits Digging Deeper Beneath the Surface," *Practical Accountant*, March 1996, p. 20.

34. See, for instance, Tracey Maclin, "The Decline of the Right of Locomotion: The Fourth Amendment on the Streets," *Cornell Law Review*, September 1990, p. 1258, and Mark Kadish, "The Drug Courier Profile: In Planes, Trains, and Automobiles; and Now in the Jury Box," *American University Law Review*, February 1997, p. 747.

35. See, for instance, Sue Blevins, "Medical Monopoly: Protecting Consumers or Limiting Competition?" *USA Today* (magazine), January 1998, p. 58.

36. Interview with Federal Trade Commission spokesman Howard Shapiro, July 28, 1998.

Next Month's *Ideas on Liberty*:

Our October issue features

Andrew Morriss and Richard Stroup on
"Quartering Species,"
Charlotte Twight on
"A Constitutional Counterrevolution,"
Walter E. Williams on "Greed and Compassion,"
and much, much more.

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IDEAS ON LIBERTY
SEPTEMBER 2000

End the Farm Dole Once and for All

A new program to require the U.S. Department of Agriculture to pay the cost of inspecting meat from emus and ostriches. A plan to spend $200 million to buy surplus cranberries, black-eyed peas, and other crops. A $100 million proposal for payments to producers of cottonseed. At this writing (June), these were among a bundle of agricultural subsidy schemes either passed by or under serious consideration in both houses of the U.S. Congress.

But wait a minute! When landmark legislation to get the government out of the crop subsidy business passed in February 1996, *U. S. News & World Report* told us, "the government will abandon the elaborate system of price supports that restricted the amounts of corn, wheat, cotton, rice and feed grains farmers could grow." Private crop insurance was going to take the place of incessant public disaster relief. Uncle Sam, we were advised, was about to liberate both farmers and taxpayers from decades of public policy folly. It was to be a crowning achievement of a new Republican majority pledged to curtail the size and intrusiveness of the federal establishment.

Then-Speaker of the House Newt Gingrich assailed the "East German socialist" farm programs built up since the New Deal. President Clinton signed the "Freedom To Farm Act" designed to wean farmers from handouts by 2002.

A funny thing happened on the way to a free market in farming. Commodity prices on world markets took a dip, farm-state interests started agitating again for bailouts, and our courageous Congress blinked. In 1999 federal payments to American agriculture soared to a record $22.7 billion—no less than three times what the figure was when the Freedom to Farm Act was passed in 1996.

Quotas on foreign sugar already translate into a sugar tax of about $1 billion annually, paid for by every American consumer. Yet by the time this column is published, Congress may succumb to great pressure from sugar producers to buy 350 million pounds of surplus sugar that nobody wants. Subsidies to tobacco farmers continue as well, at the same time the government doing the subsidizing is suing tobacco companies for the illnesses it says their product causes. Milk consumers pay an extra $1 billion annually in milk prices because of federal meddling, and consumers of manufactured dairy products like cheese and butter pay an extra $400 million—facts that make a mockery of the same government's "war on poverty." (See Kevin McNew, "Milking the Sacred Cow: A Case for Eliminating the Federal Dairy Program," Cato Policy Analysis No. 362, December 1, 1999.)

We've come a long way from the day when President Grover Cleveland vetoed a $10,000 appropriation for Texas farmers, warning, "though the people support the Government, the Government should not support the peo-

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ple." American farmers are more dependent on politicians than ever, and today's farm policy looks less like the free-market rhetoric of '96 and more like the policies of 91—that's 91 A.D., when the Roman emperor Domitian rigged the grape market to raise the price of wine.

One of the destructively stupid things the 1996 law was supposed to cure was the penchant for federal farm policies to reward the large and corporate well-to-do and thereby confer a competitive *dis*advantage on small family farms. Payments to the richest 10 percent of farmers—mostly large corporate agriculture firms—were running at more than twice the amount of payments to the poorest 50 percent of farmers, mostly small operations run by single families. Nothing since 1996 has changed that. Even the current secretary of agriculture acknowledges that the federal government continues to subsidize big operations while driving smaller farms out of business.

While big farmers reap most of the ever-higher federal payments, the national glut of foodstuffs fostered in part by those subsidies is choking all farmers with ever lower prices. The Agriculture Department forecasts that the price of soybeans this year will be the lowest in 27 years and the price of wheat and corn will be at their lowest level since 1987.

The sad fact is that 70 years of federal meddling on the farm has produced almost nothing but trouble for both farmers and consumers. As we've seen, it has been especially hard on *small* farmers and *low-income* consumers. No policy that produces such havoc can be justified.

But, some would say, the free market is hard on farmers too. In 1800, 97 percent of Americans lived on farms. Today, about 2 percent do. Free markets made farmers so productive that just 2 percent now produce more foodstuffs than we Americans—and much of the world—can possibly eat. The market has been weeding out the least efficient farms for at least 200 years.

Before anybody cries crocodile tears for agriculture, let's recognize an important fundamental principle of economics: *consumption, not production, is the ultimate end of human economic endeavors*. We produce in order to consume, not the other way around. Furthermore, as human energies, physical resources, and capital become less in need in one area, they are free to work their wonders in others. If 97 percent of our people were employed on the farm at today's levels of productivity, we would be buried in rotting food and deprived of endless other products and services today's nonfarmers provide.

Experience since the federal government became a major player in agriculture seven decades ago, including recent years when Congress made promises to restore a free market but didn't deliver, argues decisively for one rather obvious scenario: a genuine free market in agriculture. That means no subsidies, no quotas, no handouts of any kind—just the same market forces that determine almost every other good's supply and demand.

Congress should finally do what it only promised in 1996. After ceaseless failures of intervention, legislators have no excuse for not getting it right the next time. □

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IDEAS ON LIBERTY
SEPTEMBER 2000

Economists Against the FDA

by Daniel B. Klein

A sulfa drug called Elixir Sulfanilamide released in 1937 killed over 100 Americans, mostly children. A sedative called Thalidomide released in Europe in 1957 and taken by pregnant women caused deformities in 10,000 children. These famous episodes strike us as horrible injustices that must be prevented.

But more deadly are quack platitudes that guide public policy. Platitudes such as "safety," "consumer protection," and "imperfect information" have paved the way for a government stranglehold on the pharmaceutical industry. The Food and Drug Administration (FDA) decides whether to permit a company to manufacture and sell a drug or medical device and what the company may say about it.

In medical matters, expertise and good sense should decide. In policy matters, expertise and good sense also should decide—but they do not. The issue here is one of economic policy, not medicine. The true "doctors" for drug policy are the political economists. But as economist John Calfee says, "the FDA has never sought to accumulate expertise in economics."[1] Quacks make policy against the doctors' orders.

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Many economists have studied the FDA. Their diagnosis is well expressed by Nobel-winning economist Milton Friedman: "The FDA has done enormous harm to the health of the American public by greatly increasing the costs of pharmaceutical research, thereby reducing the supply of new and effective drugs, and by delaying the approval of such drugs as survive the tortuous FDA process."[2] Other economists' prescriptions regarding the FDA are uniformly libertarian, ranging from gradual decontrol to outright abolition of the agency (as Friedman recommends). Although one can occasionally find remarks by economists vaguely favoring government restrictions on health products, those are not the economists who have written on the FDA or provided serious argumentation.[3] I have tried to survey all economists' writings on the FDA and have not been able to find a single instance of an economist defending the contemporary FDA or advocating tighter restrictions. Contrary to the joke about laying all the economists end to end, those who study the issue *do* reach a conclusion: Relax restrictions on drugs and devices.

But the good policy doctors are largely ignored. The result has been like a plague. Yet the journalists and educators have not explained it or its FDA origins. Economists and libertarians are up against a Goliath—the country's entire quack political culture.

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Today men with risk of heart trouble know to take half an aspirin a day. By 1988 it was well established that aspirin greatly reduces the risk of myocardial occlusion. But for years the FDA forbade aspirin makers from advertising that fact (the FDA still significantly restricts advertising about it). The FDA surely killed tens, and quite possibly hundreds, of thousands of Americans by this restriction alone.[4]

The FDA delays, stifles, and suppresses life-saving drugs and devices. Such drugs and devices as Practolol, Interleukin-2, Taxotere, Vasoseal, Ancrod, Glucophage, Navelbine, Lamictal, Ethyol, Photofrin, Rilutek, Citicoline, Panorex, Femara, Prostar, Omnicath, and Transform have been subject to long delays, killing tens of thousands and causing awful suffering.[5]

The drug delays we can list, taken together, are just the tip of the iceberg. A 1987 study catalogued 192 generic and 1,535 brand-name tested drugs available abroad but not approved in the United States. Of the drugs approved by the FDA between 1987 and 1993, fully 73 percent had already been approved abroad.[6] And because the FDA process is so expensive, so protracted, and so uncertain, thousands of untold drugs are never discovered or developed. It is impossible to estimate the suffering and death caused, but surely it greatly exceeds 50,000 premature deaths annually.

Here one might object, "But isn't your diagnosis one-sided? Doesn't the FDA screen out unsafe drugs?"

Quality and Safety Assurance Without the FDA

First of all, "safety" is not a yes-or-no issue. Is chemotherapy safe? Medicine is often poison. The safety of a drug depends on myriad particulars about the patient: age, physical strength and condition, attitude and spirit, activities, allergies, diet, dosage, medical attention, and drug regimen. In 1994 adverse reactions to FDA-approved drugs killed 106,000 hospital patients.[7] Inevitably, many people will suffer and die from unwanted side effects. (In 1998, about 130 people died while on Viagra; speculation continues over whether these deaths are to be attributed to side effects of the drug or excitement "under the influence.")

That said, I am prepared to grant that few FDA-approved drugs are flagrantly unsafe. But here's the important point: *Drug safety would be—and is—certified and assured by a panoply of private-sector, voluntary institutions and by the tort system.* When a company harms consumers with an unsafe drug, it suffers devastating losses. Its reputation suffers, and it pays hefty damages to victims. In deciding which drugs to use, consumers seek various assurances by:

- asking the doctor which drug to take;
- choosing doctors affiliated with health organizations (such as hospitals, clinics, medical groups, and insurers);
- buying drugs of brand-name manufacturers;
- buying drugs from reputable pharmacies and supermarkets;
- being an "active patient" by researching therapies in libraries and on the Internet (at encyclopedic drug databases, such as the WebMD or onHealth Web sites).

Meanwhile, our providers and agents seek assurances in more professional ways—mysterious to us, but not to those involved:

- drug review by medical insurers;
- seal of approval or evaluations by independent organizations (ECRI, *American Hospital Formulary Service Drug Information*, *US Pharmacopoeia*);
- professional newsletters (*Clinica*, *Health Devices Alert*, *The Medical Letter*);
- scientific testing and publishing (*The New England Journal of Medicine*, and others).

Ultimately, the whole enterprise of medical science is about safety and efficacy! Malpractice or negligence is a professional scandal for the private organizations involved. They work hard to avoid blights to their reputation, quite apart from the FDA. Consumers desire not only quality and safety but also *assurance* of quality and safety. The quality of the thing offered may be excellent, but if consumers lack confidence about that quality, they

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abstain from buying. Confidence comes by way of meaningful assurances of quality, so entrepreneurs have incentives to provide that assurance.[8]

Quality and Safety Assurance Without the FDA: Four Proofs

Although some might tell you otherwise, voluntary society (plus the tort system) can provide assurance at least as well as government intervention can. Here are four empirical proofs of the claim.

Assurance in Other Industries. How is safety assured in other industries? In electronics, manufacturers submit products to Underwriters' Laboratories, a private organization that grants its safety mark to products that pass its inspection. The process is voluntary: manufacturers may sell without the UL mark. But retailers and distributors usually prefer the products with it.

Suppose someone proposed a new government agency that forbade manufacturers from making any electronic product until approved by the agency. We would think the proposal to be totalitarian and crazy. But that is the system we have in drugs. It is inconsistent to favor the free-enterprise approach to assurance in electronics but the totalitarian approach in drugs. Sometimes people rejoin: "You can't compare drugs to a toaster! Drugs have much larger effects on our physical well-being." The point, however, cuts both ways. Because drugs are so important, the downside of government restrictions is enormous—as we have seen.

Calamity Before 1962? The FDA was much less powerful before 1962. The historical record—decades of a relatively free market up to 1962—shows that free-market institutions and the tort system succeeded in keeping unsafe drugs to a minimum. The Elixir Sulfanilamide tragedy (107 killed) was the worst in those decades.[9] (Thalidomide was never approved for sale in the United States.) The economists Samuel Peltzman and Dale Gieringer have made the grisly comparison: the victims of Sulfanilamide and other small tragedies prior to 1962 are insignificant compared to the death toll of the post-1962 FDA.[10]

Were They Dropping Like Flies in Europe? Most countries have their own counterparts to the FDA. But other countries approve drugs quicker. From about 1970 to 1993 the approval times for drugs and devices in the United Kingdom, France, Spain, and Germany was significantly shorter than in the United States.[11] As we have noted, delays mean morbidity for patients. Although FDA drug approval times have improved and are now similar to those in Europe, the prior period of U.S. "drug lag" suggests a lesson about drug approval.[12]

The European agencies took less time to approve new drugs, but such laxness did not produce a scourge of unsafe drugs. As researchers of the Tufts Center for the Study of Drug Development write: "the probability that a marketed drug will be removed for safety reasons was not appreciably greater in the United Kingdom than in the United States."[13] Lighter approval requirements did not lead to any noticeable problem. One explanation would be that the European agencies function more effectively (and there is reason to believe this). Yet I am inclined to think that in both Europe and the United States the government approval process, as a means of assuring safety, is *superfluous*.

Even without government approval, voluntary institutions and the tort system would use scientific testing and professional certification to screen out unsafe drugs. The government approval process here and abroad is a set of bureaucratic hoops and hurdles often inappropriate or unnecessary for the drugs in question.

The Hidden Lesson in Off-Label Prescribing: Proof that we don't need FDA approval of drugs can even be found in America today. A drug's FDA-approved uses are called its "on-label" uses. Once a drug is approved for any use, it may be used in any way doctors and users see fit. Approved drugs are often found to have other benefits, and doctors learn to prescribe those drugs for such "off-label" uses. Although off-label uses have absolutely no standing with or approval by the FDA, they are perfectly legal. Do patients and doctors shrink in fear from uses not certified by the FDA?

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Absolutely not! Off-label prescribing is pervasive and vital to the health of millions of Americans. As economist Alexander Tabarrok says, "most hospital patients are given drugs which are not FDA-approved for the prescribed use."[14] Off-label prescriptions are especially common for AIDS, cancer, and pediatric patients, but are standard practice throughout medicine.

Doctors learn of off-label uses from extensive medical research, testing, newsletters, conferences, seminars, Internet sources, and trusted colleagues. Scientists and doctors, working through professional associations and organizations, make official determinations of "best practice" and certify off-label uses in standard reference compendia such as *AMA Drug Evaluations*, *American Hospital Formulary Service Drug Information*, and *US Pharmacopoeia Drug Information*—all without FDA meddling or restriction. Economist J. Howard Beales finds that off-label uses that later got FDA recognition appeared in the *Pharmacopoeia* on average 2.5 years earlier.[15] Where voluntary society finds room to stand, its practices lead, not follow, government determinations.

No one would be foolish enough to suggest that the FDA prohibit off-label prescribing. But as Tabarrok astutely points out, there is a logical inconsistency in allowing off-label prescribing and requiring proof of efficacy for the drug's initial use. Logical consistency would require that one *either* oppose off-label uses and favor initial proof of efficacy, *or* favor off-label prescribing and oppose initial proof-of-efficacy. Experience recommends the second option. Efficacy requirements should be dropped altogether!

Quackery Often Prevails

A drug may be developed, tested, and found to save lives. But the FDA will prevent Eli Lilly, Rite Aid, and Kaiser Permanente from making the drug available until it has gone through the tortuous and expensive approval process. That might take ten years. It might take forever if the drug is for a rare disease (and hence a small market). Because voluntary society would accomplish anything that the FDA accomplishes, the harms of the FDA are unredeemed.

Economists from Adam Smith to Milton Friedman have had the unenviable task of pointing out that popular, well-intentioned cures are often worse than the disease. Economists seem nasty when they report that the FDA is bad medicine. People don't like to hear that they have bought into quackery. In collective decision-making, quackery often prevails over sense. □

1. John E. Calfee, "The Leverage Principle in the FDA's Regulation of Information," in *Competitive Strategies in the Pharmaceutical Industry*, ed. R. B. Helms (Washington D.C.: American Enterprise Institute, 1996), pp. 306–21.

2. Quoted in Durk Pearson and Sandy Shaw, *Freedom of Informed Choice: FDA Versus Nutrient Supplements* (Neptune, N.J.: Common Sense Press, 1993), p. 39.

3. Economists making passing remarks vaguely favoring government restrictions on health products include Jerome Rothenberg, "Social Strategy and the Tactics in the Search for Safety," *Critical Review*, Spring/Summer 1993, pp. 159–80, especially pp. 166, 172, and Paul Krugman, "Natural Born Killers," *New York Times*, March 22, 2000.

4. Alison Keith, "Regulating Information about Aspirin and the Prevention of Heart Attack," *American Economic Review*, May 1995, pp. 96–99.

5. A chief source of information about drug development and approval is the Tufts Center for the Study of Drug Development. Its information is often mined and analyzed from a libertarian perspective by researchers at the Competitive Enterprise Institute (see both organizations online).

6. Kenneth Anderson and Lois Anderson, eds., *Orphan Drugs* (Los Angeles: The Body Press, 1987). Henry I. Miller, "Failed FDA Reform," *Regulation*, 3, 1998, p. 24.

7. Jason Lazarou et al., "Incidence of Adverse Drug Reactions in Hospitalized Patients," *Journal of the American Medical Association*, April 15, 1998, pp. 1200–05.

8. See Daniel B. Klein, *Assurance and Trust in a Great Society*, Foundation for Economic Education Occasional Paper no. 2, 2000.

9. Dale H. Gieringer, "The Safety and Efficacy of New Drug Approval," *Cato Journal*, Spring/Summer 1985, pp. 177–201, provides a table of cases worldwide, 1950–80, with at least 100 casualties from an unsafe new drug (p. 192). There are *none* listed for the United States from 1950 to 1962.

10. Gieringer; Sam Peltzman, "The Benefits and Costs of New Drug Regulation," in *Regulating New Drugs*, ed. Richard L. Landau (Chicago: University of Chicago Press, 1973), pp. 114–211.

11. Kenneth I. Kaitin and Jeffrey S. Brown, "A Drug Lag Update," *Drug Information Journal*, 29, 1995, pp. 361–73; Robert Higgs, "How FDA is Causing a Technological Exodus: A Comparative Analysis of Medical Device Regulation: United States, Europe, Canada, and Japan," Competitive Enterprise Institute, March 1995.

12. Elaine M. Healy and Kenneth Kaitin, "The European Agency for the Evaluation of Medicinal Product's Centralized Procedure for Product Approval: Current Status," *Drug Information Journal*, 33, 1999, pp. 969–78. It should be noted that approval is but the last stage in the development of a drug, and the FDA reaches far back into the clinical-testing stages of drug development. Therefore, looking only at approval times does not give a complete picture of whether the FDA now keeps pace with its European counterparts. Historically drug development has taken longer in the United States. Whether the "drug lag" in this broader and fuller sense is diminishing is not yet established.

13. Quoted in Kaitin and Brown, pp. 370–71.

14. Alexander Tabarrok, "Assessing the FDA via the Anomaly of Off-Label Drug Prescribing," *The Independent Review*, Summer 2000, pp. 25–53.

15. J. Howard Beales III, "New Uses for Old Drugs," in Helms, pp. 281–305.

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IDEAS ON LIBERTY
SEPTEMBER 2000

Trade and Freedom in China: A Reality Check

by Christopher Lingle

China's authoritarian government regularly and systematically ignores universally recognized rights. It is beyond dispute that the Communist Party detains individuals for expressing political opinions and for practicing religious beliefs that are viewed to be subversive to the control of the central authorities.

Apologists for Beijing often try to raise an argument based on moral relativism or a suggestion that China's underdeveloped economy is a mitigating factor. However, violations of human rights cannot be dismissed on grounds of cultural differences or of stages of economic development.

Ironically, it can be argued that overseas Chinese are responsible for the limited outcry over Beijing's abuses. Although ethnic Chinese around the world exhibit pride in their heritage, they avoid critical assessments of what that culture has brought the country of their origin. It would appear that individuals of Chinese descent are less moved by persecution of their ethnic brethren than were African Americans who led the anti-apartheid movement.

Instead, there are assertions that the best way to improve human rights in China is through trade and investment. Multinational corporations are portrayed as an important engine of change that will generate a "multiplier" effect to improve the lot of Chinese citizens. It is partially true that foreign trade and investment in China can contribute to prosperity for some people in a few parts of China. However, the impact of external economic influences cannot raise the standard of living of most Chinese in an extensive or substantial manner.

On the one hand, economists offer little evidence to identify or quantify multipliers of any sort that generate an appreciable impact. Even if multipliers have worked elsewhere, it is far-fetched to expect them to operate in China's economy. First, there are large disparities of income between urban and rural areas due to uneven economic development. Second, these gaps can be expected to widen until China develops the physical infrastructure needed for a unified, national economy. As it is, the poor communication or transportation networks do not provide adequate links between the commercial centers of the hinterland.

On the other hand, after 20 years of economic reform and hundreds of billions of dollars in foreign investment, foreign-invested enterprises employ less than 1 percent of the Chinese labor force. Given the slowdown in foreign direct investment into China, this proportion is unlikely to rise significantly.

Encouraging Democracy?

The belief that trade will democratize China has been supported by political theo-

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rists ranging from Aristotle to Seymour Martin Lipset, who argued that democracy is more sustainable only after a country reaches a threshold level of economic development. There is some evidence to support the belief. Taiwan's presidential election might be treated as a case where economic development encouraged democratization.

However, the object is not merely about the right to vote, itself a necessary and sufficient condition for a regime to call itself a democracy. Rich Singapore considers itself a democracy despite its petty repressions and government-orchestrated attacks on political opposition figures. Many other developed Asian economies have political systems that are paragons of "illiberal" democracy and lack the trappings of a civil society.

There is little evidence that prosperity provides the impetus for the formation of civil institutions. A mature civil society will have mechanisms for contract negotiation, the nonarbitrary application of the rule of law to protect individual rights and private property, a commitment to open and competitive economies as well as accountable and transparent political governance. Most Asian countries score low on this list.

The middle class may indeed be a necessary element of the formation of civil society that serves as a counterbalance to government abuse. However, an emerging, prosperous bourgeoisie is not sufficient to moderate authoritarian rule. Co-optation of the middle class and the implementation of government-sponsored organizations can supplant or forestall voluntary and spontaneous arrangements.

Encouraging Meritocracy?

There are also claims that international companies will inspire the cadres to operate as if they were in a meritocratic setting. Most multinational corporations face the hindrance of having a local joint partner, most of whom have acquired their wealth and power through connections to the Party. With so few opportunities for individuals to work in private-sector firms, there are still strong incentives for many others to seek their fortune by joining the Communist Party or working for a state-owned enterprise.

Because of the severe restrictions on the development of private-sector initiatives by both domestic and foreign interests, few state-owned enterprises are forced to face open competition. So there is little pressure on them to introduce better employment practices to increase productivity and improve product quality. It will be a long time before there are enough self-made entrepreneurs to join with employees in foreign-based corporations to be an effective force to influence political outcomes. Therefore, it is a stretch to believe that foreign influences can accelerate and expand the middle class and contribute to China's democratization.

Proponents of China's entry into the World Trade Organization or of permanent normal trade relations rely on similar exaggerations. The pressure on social change is likely to be so slight and take so long that these initiatives will have little influence over China's authoritarian government.

In light of the small impact that can be expected, it seems that it is time for a reality check on what changes can be expected in China. In the end, the issue is not whether free trade is a good thing—it is. It's whether trading with China will civilize the communists (it may) and how long it might take for the benefits to take hold there. It's likely to be a very long time, especially if the communists remain in power. □

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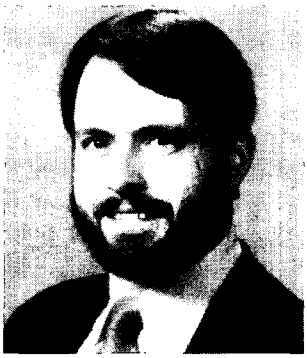

Bipartisan Drug Entitlement

Washington came close to wrecking the U.S. health-care system in 1994. Only resolute resistance to the Clinton administration's proposal to take over American medicine prevented this nation from proceeding down the disastrous path of nationalized care prevalent around the world.

Although defeated in his attempt to gulp down the health-care system, President Clinton has succeeded in expanding federal control one bite at a time. Washington is now targeting the pharmaceutical industry.

Congressional Democrats unveiled a $200 billion "drug benefit" as part of Medicare. The "me-too" Republicans, determined to surrender on every important issue, have pushed their own plan.

The fight over pharmaceuticals demonstrates how accustomed Americans have become to the proverbial free lunch. Drugs seem expensive, but the alternatives are more costly. Pharmaceuticals extend our lives, improve our well-being, and replace more dangerous treatments, such as heart bypass surgery.

Indeed, because even expensive prescription drugs are so cost-effective, limiting their use actually increases medical expenses. An attempt by New Hampshire to restrict the number of prescriptions for Medicaid recipients caused an upsurge in doctors' visits, hospitalizations, and nursing home admissions.

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The reason drugs seem so expensive is that private insurance and government programs, particularly Medicare, cover a lower percentage of their cost than of other care. Thus, Americans used to getting their medical attention for "free" are horrified at having to actually pay for pharmaceuticals.

However, the very purpose of insurance is to protect against unexpected, catastrophic expenses, not lesser, routine ones. Insurance should cover cancer treatment, not birth control pills.

The demand that health "insurance" pay for everything has grossly inflated its cost. Indeed, the health care "crisis"—spiraling prices and growing numbers of uninsured, as well as rising premiums—reflects the fact that expanded "insurance," public and private, has turned medicine into a cost-plus system.

More than three-fourths of every medical bill is directly paid by someone else. Since patients cover only a fraction of the cost, they want the most expensive and convenient treatment as soon as possible.

But those responsible for the bills want to pay as little as possible, giving rise to managed care and HMOs, which restrict treatment and ration by inconvenience. The government has also imposed de facto price controls through Medicare and Medicaid, reducing access to and the quality of care.

A federal pharmaceutical program would have the same effects. First, the costs would inevitably rise far faster than forecast. Cut the effective cost of medical care, and people will want more of it. The costs of Medicare, Med-

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icaid, and renal dialysis coverage all began soaring the moment the programs took effect. At Medicare's inception the House Ways and Means Committee predicted that the program would cost $12 billion in 1990, a staggering $95 billion underestimate. Spending actually exceeded $12 billion in 1975. The initial costs of Medicare's kidney dialysis program, passed in 1972, were more than twice projected levels. And just eight months after passage of the 1988 Medicare Catastrophic Coverage Act, soon repealed in response to popular protest, the Congressional Budget Office hiked its five-year cost estimates by upward of 100 percent.

Second, as costs rise, the pressure for price controls will grow. Congressional catfights over Medicare and Medicaid reimbursement rates are already routine. States like Vermont are threatening to limit prices because foreign citizens allegedly can purchase pharmaceuticals for less.

Yet price controls would backfire. While government can effectively confiscate existing products, it cannot create new drugs. Limiting what pharmaceutical makers can charge would cause them to reduce research and development.

Since 1962 both the total cost of bringing drugs to market, and the length of time devoted to testing and review, effectively cutting a product's patent protection, have more than doubled. The process now averages 12 years.

Moreover, the risks are enormous. There are typically 30,000 to 45,000 medical articles on drug therapies a year. Government patents for drugs usually range between 2,000 and 4,200 a year; companies list about half that number as investigational new products with the Food and Drug Administration. Nearly another half fall out by Phase Three of the testing process, and companies end up filing applications for barely 80 to 250. The FDA then approves between 20 and 60. Concludes Michael Ward, staff economist at the Federal Trade Commission, "In all, firms will market about one out of a hundred of the products for which they have developed patents."

Finally, two-thirds or more of new drugs that reach the market don't ever recover their full costs. Most ideas never get beyond the research stage.

Not only would price controls cause companies to spend less, but they would also focus their efforts on sure things: minor improvements in existing products rather than dramatic innovations in new fields.

Because American pharmaceutical makers remain relatively free, drugs are one of the nation's most successful industries: U.S. firms have developed roughly half the pharmaceuticals marketed worldwide since the 1970s. Between 1973 and 1986 American firms accounted for ten times as many drug patents as Germany and Japan, 16 times as many as Great Britain, and 20 times as many as France.

Price controls in other nations don't even do much to reduce drug costs. Although a variety of studies have claimed that U.S. prices range upward of one-third more to double those in Britain, Canada, and Mexico, Patricia Danzon of the Wharton School warns that these analyses are typically flawed, ignoring the role of generics and volume discounts in America. Danzon concludes that U.S. prices are in the middle. She and a colleague found that "the average U.S. consumer would have paid 3 percent more in Canada, 27 percent more in Germany, 30 percent less in France, 9 percent less in Italy, 8 percent less in Japan, 44 percent more in Switzerland, 9 percent more in Sweden, and 24 percent less in the [United Kingdom]."

At the same time, drug price controls have inflated overall health-care costs. A 1999 Boston Consulting Group (BCG) study concluded that the introduction of a "drug budget" in Germany increased specialist referrals, hospitalizations, and treatment costs, wiping out about 60 percent of the expected savings.

Legislators must reject any proposal that would expand government control. Election-minded politicians see rewards in demonizing the drug companies. But the pharmaceutical industry is doing infinitely more than Congress to improve Americans' health. □

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IDEAS ON LIBERTY
SEPTEMBER 2000

The Colonial Origins of American Liberty

by Thomas E. Woods, Jr.

It has recently been suggested that we cease to use the term "Founders" to refer to those American thinkers and politicians who influenced the formation of the American union and the writing of the Constitution and insist instead on the term "framers." This idea has much to recommend it. "Founders" possesses certain unacceptable overtones. It suggests that a group of men at a discrete moment in time "founded" the United States out of thin air, as though nothing were owed to the colonial inheritance. But to understand the true history of American liberty, we have to begin not with the 1780s and the Constitution, but with Jamestown and Massachusetts.

By now the thesis of David Hackett Fischer's important book *Albion's Seed: Four British Folkways in America* is familiar to students of colonial America. The period from 1629 through 1775, commencing with the emigration of English Puritans from the east of England to Massachusetts Bay and concluding with the stirrings of revolution, was characterized by the migration of peoples from four distinct regions of England. Following the Puritans, Fischer identifies as a second group a small, putative aristocracy and a sizable number of indentured servants who originated in the south of England who made their way to Virginia (c. 1642–75). The third migration originated in the North Midlands of England and Wales and terminated in the Delaware Valley (c. 1675–1725). Finally, from approximately 1718 through 1775, a fourth group, consisting of immigrants from the borders of North Britain and northern Ireland, made their way to the Appalachian backcountry.[1]

Naturally, these groups shared a number of obvious and important traits. They hailed from the same part of Europe, spoke a common language, and at least in a broad sense shared the same religion. Indeed, it was precisely these shared characteristics that John Jay cited in the *Federalist Papers*— specifically #2—as a crucial source of the comity and order that characterized the American republic. "Providence," he wrote, "has been pleased to give this one connected country to one united people—a people descended from the same ancestors, speaking the same language, professing the same religion, attached to the same principles of government, very similar in their manners and customs." In other words, the peoples of the various colonies possessed enough common characteristics to make a federal union a plausible idea and at least theoretically possible in practice.

But while much of Jay's analysis is well taken, Fischer insists that the cultural differences between the peoples who comprised the United States were real, significant, and enduring. In the mid-seventeenth century one Puritan, speaking of Virginians, declared them "the farthest from conscience and moral honesty of any such number together in the

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world." Likewise, the Virginian William Byrd II, referring to the Puritans, warned a correspondent that "a watchful eye must be kept on these foul traders." The two groups, in turn, shared a dislike of the Quakers. (It was frequently said that members of the Society of Friends, as the Quakers were known, would "pray for their fellow men one day a week, and on them the other six.") The Quakers returned the favor. Although the Puritans thought they had purged their worship of the ritual and "superstition" that had made the Church of England so distasteful to them, theirs was still too outward and formalistic a religion for the Quakers. Decades before William Penn settled Pennsylvania in the 1680s, Quakers living in Rhode Island and elsewhere would make their way up to Massachusetts in an effort to rouse its benighted inhabitants from their dogmatic slumber and awaken them to the aridity of their faith. Quakers would disrupt Puritan church services, heckle ministers, and on occasion would even walk naked up and down the church aisles. The Friends were banned repeatedly from Massachusetts. In turn, as late as 1795 one Quaker referred to New England in general as "the flock of Cain."[2]

The mutual antagonism of these groups contributed in a peculiar way to the development of American liberty. Each of these peoples would be vigilant to exclude interference in their internal affairs by any of the others. The much-heralded problem of reconciling the interests of large and small states at the Constitutional Convention has, in Fischer's view, obscured the more interesting, meaningful, and revealing task of the framers, which was "to reconcile different political cultures," as they were found in the various regions. (One of the reasons Patrick Henry opposed the Constitution was that he believed it did not go far enough in ensuring regional integrity; he was sure that when one section became powerful enough, it would use its clout to oppress the others.)

Delicate Balance

Balancing these different political cultures was often a delicate procedure indeed. The

Rufus Choate (1799–1859)

very idea of freedom possessed varying connotations in the several colonies. When, for example, the First Amendment declared that "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof," this "deceptively simple statement," in Fischer's view, concealed a "regional compromise of high complexity." "Its intent," he goes on, "was to preserve religious freedom of Virginia and Pennsylvania, and at the same time to protect the religious establishments of New England from outside interference."[3] To develop a policy that would be satisfactory to all, therefore, it was simply decided that the federal government should have no authority whatever vis-à-vis the various religious postures adopted by the several states.

There was, of course, a great deal more than mutual antagonism that gave impetus to the tradition of American liberty. What characterized the American colonists, for the most part was, first, sheer practicality—they were practical men, not schemers—and second, an unswerving commitment to self-government. These two qualities are not easily separated; when, for example, the states cautiously rati-

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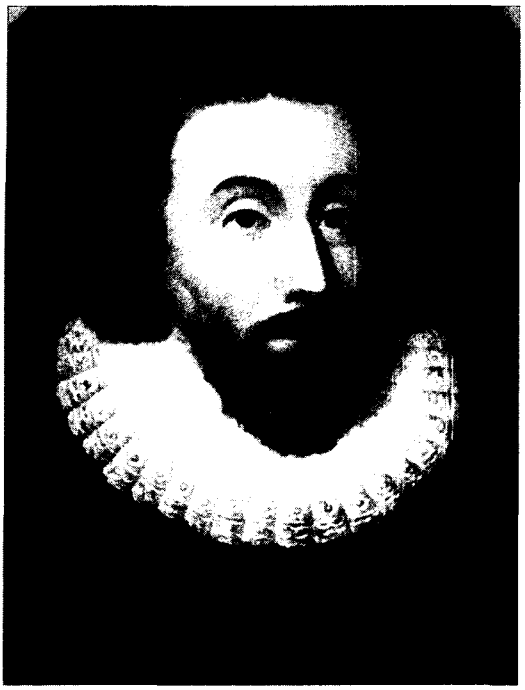

John Winthrop (1588–1649), first governor of Massachusetts Bay Colony

fied the federal Constitution in the 1780s, their insistence that it remain a strictly limited union was based partly on their unwillingness to relinquish major prerogatives of self-government, and partly on their lack of interest in making a confederation an end in itself, or a self-justifying goal, as Clyde Wilson put it. The American revolutionaries were not like the French, the most radical of whom sought to extirpate the smallest remnant of pre-revolutionary France from historical memory. The Americans had no intention of anticipating the French example by abandoning the Gregorian calendar and beginning anew with the Year I in commemoration of the establishment of the new republic. The American union was simply a practical arrangement, brought into being to accomplish specific and finite objectives.

Lasting Liberty

It was precisely the lack of inclination among any of these peoples to remake the world, or even their own civilization, according to an arbitrary blueprint that helped make American liberty both possible and lasting. The nineteenth-century Massachusetts Whig Rufus Choate, an important American legal thinker and sometime congressman and senator, pointed with pride to the sober judgment and statesmanship of his native section:

> There was another great work, different from this, and more difficult, more glorious, more improving, which they had to do, and that was to establish their system of colonial government, to frame their code of internal law, and to administer the vast and perplexing political business of the colonies in their novel and trying relations to England, through the whole colonial age. Of all their labors this was the grandest, the most intellectual, the best calculated to fit them for independence. Consider how much patient thought, how much observation of man and life, how much sagacity, how much communication of mind with mind, how many general councils, plots, and marshalling of affairs, how much slow accumulation, how much careful transmission of wisdom, that labor demanded. And what a school of civil capacity this must have proved to them who partook in it! Hence, I think, the sober, rational, and practical views and conduct which distinguished even the first fervid years of the Revolutionary age. How little giddiness, rant, and foolery do you see there! No riotous and shouting processions, no grand festivals of the goddess of reason, no impious dream of human perfectibility, no unloosing of the hoarded-up passions of ages from the restraints of law, order, morality, and religion, such as shamed and frightened away the new-born liberty of revolutionary France. Hence our victories of peace were more brilliant, more beneficial, than our victories of war.[4]

Nothing could have been further from the minds of the colonists than the suggestion that by virtue of having settled in a new land they had inherited a unique divine mandate to remake the world. The Puritans, it is true, spoke in terms of a divine mission. John Winthrop's biblical allusion to a "city on a hill" suggested that the godly community of

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Massachusetts Bay might lead to a regeneration of the Church of England and indeed the entire world. The important proviso, however, was that this regeneration was to take place by example rather than force. With their gaze fixed firmly heavenward, the Puritans would have considered it an act of supreme impiety and classic human folly to expect the regeneration of the world through any mere human enterprise. It was only when the stern Calvinism of the Puritans had given way to the optimistic Unitarianism of nineteenth-century New England, and ultimately to the secular utopias of Progressivism and social democracy, that the city on a hill imagery came to possess the imperialistic overtones with which we are so familiar today.

That the original Massachusetts settlements had their theocratic aspect is not really in question. The law was expected to reflect biblical precept as precisely as possible. The franchise was restricted to church members; to become a church member, one had to undergo a process for which interrogation is probably too strong a word, but one by which so-called "pillars of the church" would attempt to determine, as far as it lay within the province of human capacity to discern, whether a prospective member belonged to the elect—that is, had been eternally predestined to heaven—or to the damned. The latter group, although excluded from the franchise and from reception of the Lord's Supper, were nevertheless required to attend church. Steeped as they were in covenant theology, the Puritans believed that if they succeeded in establishing a truly godly community, God would look upon them with favor; if they failed, they would be subject to His wrath. They wished to live among like-minded folk in order better to live out a shared ideal.

In the Dedham (Massachusetts) Covenant drawn up during the 1630s, it was resolved "that we shall by all means labor to keep off from us all such as are contrary minded, and receive only such unto us as may probably be of one heart with us."[5] The entire enterprise contained an element of utopianism, to be sure, in that the settlers sought to "build the most perfect possible community, as perfectly united, perfectly at peace, and perfectly ordered as man could arrange."[6] It was, however, a utopianism that ended at the community's borderline. They wanted simply to be left alone.

Forgotten Commitment to Liberty

The community aspect of early New England has been so often emphasized that the Puritans' commitment to traditional English liberties has tended to be forgotten. Relatively little known outside the rarefied circles of colonial scholarship is the fact that it was a popular movement in the late 1630s that demanded the explicit codification of the colonists' rights. Winthrop, the key figure in the Puritan migration and a longtime governor of Massachusetts Bay, had always favored having as little written law as possible in order to give him and to give his judges the discretionary authority they believed they needed to rule in accordance with the Bible. In the minds of the colonists themselves, however, this discretion was simply too great.

In 1641, with Winthrop temporarily voted out of office on these very grounds, they secured passage of what became known as the Massachusetts Body of Liberties. The document's provisions, of which there are over 100, include items familiar to the student of British law and politics: the principle of no taxation without representation, the right to a jury trial, and the guarantee that no person would be deprived of life, liberty, or property without due process of law. (It also contains a peculiar provision prohibiting wife beating, excepting when the husband is acting in self-defense.)[7]

Over time, a series of factors would gradually dissolve what some might consider the more disagreeable aspects of community life in Puritan New England. The factors included the pressures of a growing population, which forced people to settle ever further from the town center—thereby rendering themselves less easily observed and controlled by government and religious authority—as well as the increasing attraction of theological liberalism. Thus what had once been a self-consciously corporate enterprise would eventually make room for a greater degree of individual liberty.

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Virginia's development took just the opposite path. It started off as a distinctly individualistic colony. The early settlement of Virginia was dominated by young single males. A host of factors, prominent among them Virginia's (not entirely undeserved) reputation as a disease-ridden deathtrap, served to discourage the kind of self-consciously corporate and family-oriented migration that had characterized the Puritan experience. Gradually, as the mortality rate declined and the colony's prosperity became widely known, it became more sensible for entire families to make their homes in the Chesapeake.

As Virginia became more settled and established, it also became more aristocratic. The Virginia aristocracy would grow attached to the principle of self-government, and these men took their responsibilities seriously. It was a strict requirement that every member be present especially for the opening session of the House of Burgesses, and that any absence had to be excused. Poor James Bray: in 1691 the House of Burgesses was so offended by his explanation for his absence that the Speaker actually issued a warrant for his arrest, and held him in custody until he made an apology.[8] This was government by an elite and with a restricted franchise, it is true, but the importance of the franchise in safeguarding liberty has been greatly exaggerated. (Recall that F. A. Hayek warned of making a "fetish of democracy.") What is important is that this elite was composed of an extraordinarily talented group of men who, when the crisis came, were able to articulate precisely where and how American rights and liberties were being threatened.

In keeping with most of the colonial tradition, the Virginians were also men of a uniquely practical bent. This aspect of the Virginia gentry has frequently been obscured by historians' careless conflation of this colonial elite with the French *philosophes*. It is true that Virginia planters were skilled in law, meteorology, medicine, and so forth, but this was not because they were trying to make an ideological statement about the sovereign unity of reason or any such thing. As Daniel Boorstin observes, "How devious it is to explain these plantation necessities as if they were inspired by the distant example and abstract teachings of the European Enlightenment! They were nothing more than an index to the problems of a Virginia planter."[9]

Moreover, and again in contrast with the *philosophes*, the Virginians were especially devoted to their region, to their particular plot of earth. "Their localism has been given far too little attention and too little credit," Boorstin notes. "In these days, when States' rights are out of fashion, we are too often told that a man's preoccupation with the habits of the place where he lives can only drag the national progress. We are fortunate that 18th-century Virginians thought differently. Their concern with the special requirements of their own particular place on earth not only flavored their political life and expectations; it gave all their thinking the aroma of the specific and kept all their social ideals within finite bounds."[10]

Intermediary Institutions

Ultimately, therefore, the colonies succeeded in providing the individual liberty that makes a rational and civilized life possible, while at the same time cultivating a corporate sentiment that provided a source of resistance to centralizing and consolidationist schemes. With the advantage of hindsight we can see the importance of this latter consideration, which in some libertarian analyses might be overlooked. The need for vigorous intermediary institutions was especially emphasized by the outstanding classical liberal Benjamin Constant: "The interests and memories which are born of local customs contain a germ of resistance which authority suffers only with regret, and which it hastens to eradicate. With individuals it has its way more easily; it rolls its enormous weight over them effortlessly, as over sand."[11]

The French revolutionaries, for example, despised the local customs and peculiarities that dotted their country's landscape and reorganized France into arbitrary "departments" that bore no relation to its historic regions. In our own century, the deliberate and coordinated destruction of local institutions and intermediary associations has been a principal

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weapon of various totalitarian systems in eliminating potential sources of resistance. Hitler, of course, despised German federalism, which he correctly perceived as an obstacle to his consolidation of power. Stalin, for his part, attempted to starve the Ukraine into submission when standard Soviet propaganda proved insufficient to divest it of its traditional national feeling. In the soft totalitarianism of social democracy, we have seen how our own government has abetted social upheavals at the local level in order to strengthen its control everywhere.

It was the combination of their strict practicality and their well-cultivated corporate identity that caused the American colonists to look with suspicion on confederations of any kind. That good reasons could be adduced for uniting with their fellow colonies for limited and practical purposes was not in doubt. But the terms of such confederations would have to be spelled out clearly and explicitly, and any such intercolonial alliance would have to be kept under a vigilant watch. Thus it was only belatedly that the Puritans banded together in an intercolonial alliance, the so-called Confederation of New England. Persistent rumors of imminent Indian hostilities, and ongoing suspicions of the Narragansett tribe in particular, led the colonies to consider such a move. And yet, in the classic American tradition, the colonists kept a close watch on this Confederation.

New England had lived without incident for some years in increasing proximity to New Netherland. But when in 1652 Cromwell attacked the Netherlands and the two mother countries were thus at war, the possibility of a colonial clash, with each side arming its Indian allies, worried New Englanders. Connecticut and New Haven began to beat the drums for war. "Massachusetts chose this moment," Alden Vaughan notes, "to question the fundamental right of the United Colonies to declare offensive war over the objections of any General Court. Massachusetts was not about to be dragged into an international war by its three *small and imperious* neighbors." Vaughan also observes that the strength of the Confederation was seriously impaired by Massachusetts's constitutional challenge, but this outcome only reinforces the point that the integrity of self-government was the overriding consideration in the minds of the colonists.[12]

Overreaching Crown

That the robust if zealous character of community life in Puritan New England had accustomed its inhabitants to the principle of self-government was made dramatically apparent toward the end of the seventeenth century when the Crown attempted to establish its authority more firmly there and elsewhere. Partly in an effort to ensure that British trade regulations would be properly enforced, and partly out of a legitimate concern for the colonies' effective defense against a potentially aggressive New France, King James II established during the 1680s the so-called Dominion of New England, which combined Massachusetts, Maine, and New Hampshire into a single government under a single royal governor. As time went on, James II would annex Rhode Island, Connecticut, New York, and the Jerseys to the Dominion, and had his sights on Pennsylvania at the time he was deposed.[13] Its first governor was the hapless Joseph Dudley, the son of the old Puritan governor Thomas Dudley, but the most memorable figure associated with the Dominion was the hated Sir Edmund Andros, who took power in late 1686.

Given the colonists' attachment to self-government, Andros would have aroused bitterness under the best of circumstances. But he was by temperament distinctly unsuited to the task. His style of governance seemed calculated to create resentment: he levied taxes by his own fiat, for example, and jailed those who protested these usurpations. The enraged colonists, vigilant in protecting their liberties, were waiting for an opportunity to strike. It came with the Glorious Revolution of 1688.

Communication was slow in the seventeenth century, so it was several months after the fact that the American colonies learned that James II had been deposed and William and Mary installed. On April 4, 1689, word reached Boston that the new king and queen wanted "all magistrates who have been

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unjustly turned out" to resume "their former employment." That was all the citizenry needed to hear. "The machinelike precision with which [this parallel revolution] unrolled points to careful plans and leadership, which no one has yet unearthed," writes Samuel Eliot Morison. "The townspeople rose, the countryside rose, Andros and some of his principal councillors were thrown into jail." A meeting presided over by the last governor under the Bay Colony charter adopted the "Declaration of the Gentlemen, Merchants, and Inhabitants" that had been drawn up by the eminent Puritan divine Cotton Mather.[14] The Dominion was at an end and self-rule was again in effect.

It was the same spirit that led the colonists to reject Benjamin Franklin's proposed Albany Plan of Union in 1754. Under the pressure of Indian war, Benjamin Franklin and Thomas Hutchinson—the latter of whom would play an ignominious role in the events leading up to the American War for Independence—drew up a scheme according to which the colonies would yield a considerable amount of their authority to a new intercolonial governing structure. Not a single colonial assembly ratified the plan.

We can see, then, why it is misleading to date the tradition of American liberty from the late 1780s, since the Constitution of the United States was in fact only the culmination of generations of practical self-government on the part of Americans. At the time of the framing of the Constitution and the formation of an allegedly "more perfect union," the colonists had precedents for challenging the powers of a confederation, as in the case of the Confederation of New England, for rejecting a confederation, as in the case of the Albany Plan of Union, and for bringing down a confederation by force, as in the case of the Dominion of New England. It can hardly be surprising, therefore, to learn that at the time of the ratification of the Constitution, three states—Virginia, New York, and Rhode Island—in acceding to the new confederation, explicitly reserved the right to withdraw from the union at such time as it should become oppressive. In so doing they were only exercising the vigilance and libertarian principle that had animated the American experience during the colonial period.

Thus when a union of polities becomes an end in itself, as it had in the minds of some by the time of Daniel Webster, but certainly since the Civil War, the repudiation and indeed perversion of the colonial ideal is complete. Nothing could be more obvious than the traditional American wariness of confederations—which, whatever their advantages, the colonists consistently viewed in terms of the threats they posed to self-government. Had the American union, the confederation inaugurated by the Constitution, been understood to be perpetual and indestructible, the states, which had just fought a war for self-government against the British empire, would never have entered it. What the colonial period has to teach us, then, is that the truly American sentiment is not Andrew Jackson's famous toast, "Our federal Union—It must be preserved!" but John C. Calhoun's reply, "The Union—Next to our liberties, most dear!" □

1. David Hackett Fischer, *Albion's Seed: Four British Folkways in America* (New York: Oxford University Press, 1989), p. 6.
2. Ibid., pp. 821–22.
3. Ibid., p. 830.
4. Rufus Choate, "The Colonial Age of New England," in *The Works of Rufus Choate, with a Memoir of His Life*, ed. Samuel Gilman Brown (Boston: Little, Brown, and Co., 1862), pp. 365–66.
5. Kenneth A. Lockridge, *A New England Town: The First Hundred Years* (New York: W.W. Norton, 1985), p. 5.
6. Ibid., p. 16.
7. Edmund S. Morgan, *The Puritan Dilemma: The Story of John Winthrop* (Glenview, Ill.: Scott, Foresman, & Co., 1958), pp. 155–73; Samuel Eliot Morison, *The Oxford History of the American People*, vol. 1, *Prehistory to 1789* (New York: Oxford University Press, 1965), pp. 108–109.
8. Daniel Boorstin, *The Americans: The Colonial Experience* (New York: Random House, 1958), p. 113.
9. Ibid., p. 108.
10. Ibid., p. 141.
11. Quoted in Ralph Raico, "Benjamin Constant," *New Individualist Review*, Winter 1964, p. 53.
12. Alden T. Vaughan, *New England Frontier: Puritans and Indians, 1620–1675*, 3rd ed. (Norman, Okla.: University of Oklahoma Press, 1995), pp. 174–75.
13. Morison, p. 167.
14. Ibid., p. 171.

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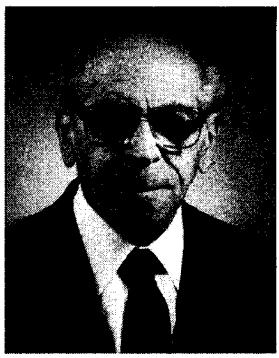

Progress in Pain Relief

"Among the remedies which it has pleased the Almighty God to give to man to relieve his sufferings, none is so universal and so efficacious as opium."
—THOMAS SYDENHAM, M.D. (1680)

The authors of the textbook of pharmacology used when I was a medical student (during World War II) stated: "*The opium alkaloids have no rival for the relief of pain. . . .*" (emphasis in the original); to support this opinion, they added: "Sydenham . . . remarked that without opium few physicians would be sufficiently callous to practice therapeutics."

The *Oxford English Dictionary* dates the origin of the term "Laudanum," an alcoholic tincture of opium, to 1600. For the next 300 years, this effective and safe painkiller was available for pennies to anyone who needed or wanted it. Throughout those centuries—indeed until after World War II—the concept of untreated or undertreated pain was absent from medical discourse.

As recently as the 1960s, cough syrup containing codeine was available over the counter and opiates were widely prescribed for pain. The terms "prescription drug abuse" and "improper prescribing habits" had not yet entered our vocabulary. Today, the unavailability of opioid analgesics (painkillers containing alkaloids of opium) *in pharmacies* is a problem studied by medical scientists.

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In the glory days of the Soviet Union, butcher shops were devoid of meat. To devout communists this was evidence of the moral superiority of socialist "social justice" over the decadent consumerism of capitalist exploitation. In the glory days of America's war on drugs, pharmacies—especially in black neighborhoods—are devoid of opioid painkillers. To devout drug warriors and to their pusillanimous critics this is evidence of medical progress in pain relief, with "racial bias" as its unintended side effect.

"We Don't Carry That"

That is the title of an article published in the April 6, 2000, issue of the prestigious *New England Journal of Medicine.* The subtitle tells the story: "Failure of pharmacies in predominantly nonwhite neighborhoods to stock opioid analgesics." The pharmacists told the authors that they do not stock opioid drugs because of "fear of theft" and "fear of penalties imposed by state and federal agencies." Anyone who lives in the United States and reads the papers or sees television could have told them this without conducting a pretentious "study," paid for by the Open Society Institute's Project on Death in America, funded by financier George Soros, and the

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National Institute on Aging, funded by the taxpayer.

As if the study itself were not enough of an insult to any informed adult's intelligence, the authors' recommendation borders on being obscene. "The problem of inadequate supplies of opioids calls for a program to *educate* pharmacists about the safe and appropriate use of opioid analgesics. . . . " (emphasis added). For centuries, uneducated peasants knew how to use opioid analgesics safely and appropriately. When did pharmacists unlearn this ancient knowledge?

It gets worse. The authors' recommendations include "an evaluation of regulations that may act as disincentives for pharmacists to stock controlled substances." Don't we know—without further studies—that if opioids were deregulated and sold in the open market, thieves would have no more reason to steal opium from pharmacies than they have to steal onions from supermarkets; and that there would be a plentiful supply of painkillers in pharmacies, just as there is a plentiful supply of food in our markets?

"Unacceptable Facts"

Our collectivistic-totalitarian drug control policies not only deprive suffering patients of the kinds of pain relief to which people had free access in the days of prescientific medicine, but they also debauch the language, robbing people of the tool necessary for recognizing that they are responsible for the problem, created by their own longing for statist protection from "drug abuse."

Underscoring the importance the editors of the *Journal* attach to the study, an editorial—titled "Racial injustice in health care"—calls the disproportionate deprivation of black patients of opioid painkillers an "unacceptable fact." However, the phenomenon they deplore is not simply a "fact." Rather, it is the consequence of a deliberate policy (another consequence being the disproportionate number of black youths deprived of liberty because of drug law violations, a "fact" the authors of neither the study nor of the editorial consider worth mentioning).

What, moreover, are we to make of physicians associated with prestigious institutions calling facts "unacceptable"? Don't they know that the adjective "unacceptable" pertains to behaviors or policies, not to facts (which simply *are*)? Or do they know it and choose this language to lower the volume of their criticism of drug policies to the point where no one will hear it and hence no one will take offense? This supposition is supported by their spouting politically correct platitudes such as: "We believe the common thread in these findings is a subtle form of racial bias on the part of medical care providers. The level and extent of this problem are unknown, but it is real and potentially harmful, even though predominantly unintentional." The "unintentional bias"—an oxymoron—is no doubt the symptom of a mental illness, due to an as yet undiscovered brain disease, for which no one is responsible.

The mind boggles. We spend more money on medical care than any other people in the world. And what is the result? That we live in a society in which suffering patients who, according to doctors, have urgent need for legal narcotics have no access to them, while people who should not have access to illegal narcotics have unlimited access to them. Who is at fault? No one. Everyone is a victim: patients, of lack of effective painkillers; physicians, of draconian drug laws making them afraid to prescribe narcotics; and pharmacists, of high crime rates, making them avoid stocking opioids in black neighborhoods.

Sydenham, as I noted at the beginning, attributed the miraculous powers of opium to relieve pain and suffering to the Almighty God. What God has given, the Therapeutic State has taken away. □

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A Light Goes Out in New Zealand

by Charles W. Baird

I have often referred to New Zealand's 1991 Employment Contracts Act (ECA) as a model of voluntary unionism that we in the United States would be wise to emulate. Notwithstanding its shortcomings—including its mandatory personal grievance provisions, its creation of the specialist Employment Court, and its failure to do anything about the minimum-wage law—the ECA made the employment relationship in New Zealand a matter of voluntary exchange for most workers and most employers on most issues.

It stripped unions of most of the special privileges and immunities they enjoyed before 1991, which placed them above the rule of law. Unions, like everyone else, were made subject to the common law of property, contract, and tort. Unions could represent only their voluntary members, and workers could choose union or nonunion third parties to represent them or could choose to represent themselves. Like unions, nonunion third parties could represent only those workers who contracted with them to do so. Bargaining was wholly voluntary. No unions, nonunion representatives, employers, or individual workers could be forced to bargain with any other party against their will. There was true freedom of association, which includes the right not to associate, for all parties in New Zealand labor markets. Freed from compulsory unionism, most New Zealand workers chose to be union-free. Between 1991 and 1999 the percentage of workers represented by unions fell from 50 to 20 percent. Employment growth accelerated, unemployment plunged, average real wages increased, and strikes almost disappeared. Public opinion polls indicated substantial and growing support for the ECA throughout the period.

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The Unions Strike Back

Union leaders, of course, abhorred ECA. Their declining market share meant fewer and fewer dollars came into their treasuries and more and more workers, journalists, and politicians were losing interest in what union leaders had to say about anything. Threatened with penury and irrelevance, union bosses pulled out all stops to return the Labour Party to power in the 1999 elections. They were assisted by the incumbent National Party government that seemed to have run out of all its reformist energy and had nothing new to offer. Labour and its coalition partner, the Alliance, won the election, giving the impression they would make only minor changes to ECA. However, it didn't take long for the union bosses to present their IOUs. At the unions' behest the coalition government cobbled together the Employment Relations Act (ERA), which became law August 1.

ERA turns the clock back to the days of special privileges and immunities for unions. Its authors adopted many of the bad features

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of our National Labor Relations Act (NLRA) and came up with some equally bad features of their own.

Worker Choice. Unlike NLRA, ERA still permits individual workers to opt out of union representation, but it stacks the decks against that option. ERA says that a union may consist of as few as two employees; and all employers, whether unionized or union-free, are forced to allow union organizers on their property to recruit workers. Unions, and only unions, have this privilege.

Once two workers join up, the employer becomes unionized and is forced to bargain with the union in good faith. Only unions may engage in collective bargaining and enter collective agreements with employers. Where a collective agreement is in effect, all newly hired workers are made subject to its provisions for 30 days, after which a worker may opt out of the collective agreement, remain union-free, and work out an individual contract with the employer. However, notwithstanding any terms in an individual contract, an employer must allow every union-free worker to join the union and become subject to the collective agreement at will. So most employers are likely to be forced to bargain with unions, and union-free workers will find it difficult to avoid the blandishments of union organizers. Moreover, employers must provide only "neutral" advice to workers on joining collective agreements. ERA tolerates only pro-union propaganda. Employers may not "undermine the integrity of a collective agreement" by offering inducements to workers, but unions may undermine the integrity of individual contracts by offering inducements to workers. ERA states that it "protects the integrity of individual choice." Some integrity, some choice!

Speaking of propaganda, ERA forces employers to give union workers from five to 35 days (depending on firm size) of paid leave each year for "employment relations education leave." Of course the education is provided by the unions. I am reminded of the mandatory "sensitivity training" imposed on many American college campuses for students with politically incorrect views.

Replacement Workers. Under the principles of voluntary exchange, if person A refuses an offer from person B, person B is free to make the same offer to person C. This is now the rule in all markets in New Zealand except the labor market. ERA provides that during any strike an employer is forbidden to hire replacement workers, and nonstriking workers may not be assigned to do the jobs of strikers. American unions have tried and failed to get this privilege ever since 1935. ERA implies that unions, not employers, own the jobs performed by union workers.

Labor as a Fixed Cost. ERA forces any employer "covered by a collective bargaining agreement to continue to employ every employee bound by it during the whole of the period the agreement is in force" notwithstanding any changes in business conditions. Union labor becomes a fixed cost of doing business, and union labor cannot be kept out of any firm. This will do wonders for New Zealand firms trying to compete in the global economy.

Inequality of Bargaining Power. The ERA asserts that it "acknowledges and addresses the inherent inequality of bargaining power in employment relationships." This is strange because most New Zealand workers opted for individual employment contracts under ECA. I guess they were not aware of their inherent bargaining-power inferiority relative to employers. They didn't realize how much they needed the unions, which they were always free to join, in order to reach bargaining-power parity. They must be overjoyed now that Labour Party politicians and unions have enlightened them.

As I and others have repeatedly explained, the hoary myth of a worker's inherent bargaining power disadvantage has support neither in logic nor in history. Bargaining power comes from having alternative employment opportunities. A prosperous economy, within which entrepreneurs and investors are creating increasing employment opportunities, gives workers more bargaining power than any union is likely to give. By decreasing the flexibility and resilience of labor and product

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markets, ERA will make New Zealand much less hospitable to entrepreneurs and investors, decrease real economic growth, and increase unemployment. New Zealand workers will lose, not gain, bargaining power.

Cartelization of Markets. It is widely understood that unions are labor cartels. A cartel is a group of sellers of something who agree with each other to suppress competition among themselves in order to extract monopoly prices from customers. Workers are sellers of labor, and if wages can be taken out of competition, buyers of labor (employers) will have to pay monopoly wages. ERA doesn't stop at promoting labor cartels; it also makes it easier for unions to help employers to cartelize product markets. It permits strikes in pursuit and enforcement of multi-employer collective agreements. A group of employers who are covered by a multi-employer collective agreement will all face the same labor costs and can easily translate this into uniform product prices. Associate Labour Minister Laila Harre likes this feature because it "will put an end to price competition by putting all workers on the same wage."

Mandatory Good-Faith Bargaining. The worst feature of NLRA copied by the authors of ERA is mandatory good-faith bargaining. New Zealand employers are forced to bargain with unions that represent two or more workers. At least in the United States, a union must have the support of a majority of an employer's workers before it can force him to bargain. Mandatory bargaining is bad enough, but the good-faith requirement makes things worse. ERA doesn't define "good faith." It says that "codes of good faith" must be developed in tripartite negotiations among unions, employers, and the government. NLRA doesn't define good faith either. However, even though it specifically states that it does not require the "making of a concession," case history implies that employers must compromise with unions. No take-it-or-leave-it bargaining is permitted. Employers must watch their language and show proper deference to the union negotiators. It is bad faith for employers to poll workers to find out what they want.

Good faith means only unions can speak for workers whether the workers like it or not. The only effective defense against a charge of bad faith bargaining is a record of concessions to the union. Inasmuch as Harre speaks favorably of the "North American model" of good-faith bargaining, there is little doubt that her good-faith codes will be written to give unions as much of an advantage in collective bargaining as possible.

Freedom of Association. The authors of ERA boast that it brings New Zealand into compliance with the International Labour Organization (ILO) Conventions 87 (Freedom of Association) and 98 (Collective Bargaining). Here, at least, they speak the truth. Those two conventions are used by the ILO to promote compulsory unionism all over the world. The unions complained about ECA to the ILO on these grounds in 1993. It chastised New Zealand for focusing too much on individual rights at the expense of collective or group rights. To the ILO freedom of association means that individual workers should be herded together into collectives. Any conflict between the interests of individuals and the rights of the collective are to be resolved in favor of the latter. The ILO explicitly refused to include the right not to associate with unions as part of the freedom of association. This should not be surprising since the ILO was formed by democratic socialists who saw all labor issues through the prism of Marx's labor theory of value and class struggle.

The forces of reaction have extinguished the light of freedom in New Zealand labor relations. However, I think their victory is only temporary. ECA continues to enjoy widespread public support. It is the union bosses and their Labour Party mandataries, not the workers, who are repealing ECA. If the opposition parties, particularly the National Party and ACT, can muster the energy and focus necessary to run an effective campaign that promotes continuing the free market reforms of the late 1980s and early 1990s, chances are the voters will put things right. The future still belongs to the forces of freedom. □

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Austrian "Inflation," Austrian "Money," and Federal Reserve Policy

by Richard H. Timberlake

Joseph Salerno's essay in *The Freeman: Ideas on Liberty,* October 1999, extensively criticized the series of three articles I had published in previous issues of the magazine.[1] I find none of Salerno's alternative analyses valid.

My disagreements serve to highlight the dissents many economists have with what passes as "Austrian" monetary analysis. These differences deserve to be aired in depth. However, in the short compass of this reply I can treat only the immediate monetary issues germane to the 1920s and 1930s. Therefore, I limit the remarks to four main topics: the evolution of the word "inflation"; the definition of "money"; Federal Reserve policy before and after 1933; and Federal Reserve-Treasury policy on gold and excess reserves.

Evolution of the Word "Inflation"

Whether the word "inflation" is "new" or "old and venerable" is largely irrelevant to substantive issues. "Inflation" is a word that has emerged in economic thought and theory because of institutional developments and intellectual progress in methods of economic measurement. It is useful as no other word can be for describing general price-level increases. Salerno's insistence, quoting Murray Rothbard, that it should mean only an increase in the stock of money "not consisting in, i.e., not covered by an increase [in the quantity] of gold," violates current meaning that the word has both for economists and the public. It deprives us of the word that most robustly describes a general increase in prices.

Some ancient economists undoubtedly used "inflation" to mean an increase in the stock of paper money *together with* an increase in prices. They had an intuitive understanding of the general level of prices but only an imperfect means of expressing it, because mathematicians had not developed statistical price indices. Nonetheless, most English economists, such as John Stuart Mill, Henry Thornton, and David Ricardo, writing in the early nineteenth century, distinguished clearly between changes in money stocks, whether "covered" by gold or not, and changes in the aggregate of money prices.[2]

Economists of that era were preoccupied with a search for a talisman of value so that they could specify more precisely the value of a money unit.[3] Statistical development of price indices in the mid-nineteenth century provided a more precise means of measuring

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price level changes. With this tool economists could usefully describe the value of money as the inverse of money prices, an eminently sensible idea. They could also properly distinguish between increases in the stock of money and general increases in money prices.

Everyone is well aware of the limitations of price indices; they are not perfect measuring devices. However, they furnish us with measures of central tendency so we do not have to trust our gut feelings to tell us that inflation or deflation has occurred.

The development and use of the price index is analogous to the development and use of the thermometer. Thermometers do not measure temperature perfectly; to some extent pressure changes and other factors bias the temperature reading. Also, thermometers only measure temperature "objectively"; they do not show how an individual reacts subjectively to whatever the temperature is. So are we to throw away all our thermometers because they are technically imperfect and non-subjective, that is, "non-Austrian"?

During the period 1921–1929 in the United States, the Bureau of Labor Statistics Wholesale Price Index (WPI) *fell* by 2.4 percent, and the Consumer Price Index (CPI) *fell* by 4.1 percent. Is it possible to assert in the face of this data, as Salerno-Rothbard dogma would have it, that the economy experienced an "inflation"?

A simple thought experiment best addresses the question of a 1920s "inflation." Say that a U.S. householder or businessman had the choice between $2,000 of 1921 income in 1921 dollars, or $2,000 of 1929 income in 1929 dollars? Is it conceivable that he, or even an "Austrian" economist, would choose the former income unless he reveled in asceticism? Yet if 1921–1929 witnessed the "inflation" that Salerno laments, he would have chosen the 1921 income. Since average incomes increased over the period, a worker of that era had more dollars of income in 1929 and also lower prices for almost everything. He also had much improved qualities of goods and services and more choices than he had in 1921. Would that the U.S. economy had had such an "inflation" over the last 33 years!

The Definition of Money

The question of which items economists should include in the definition of money has been debated for two centuries. Obviously, any item that is directly exchangeable for goods and services over the counter as a medium of exchange is money. Currency and demand deposits, subject to check, are clearly money. However, what about time and savings deposits, savings and loan share capital, and cash surrender values of life insurance policies—the items Salerno (and Rothbard) include in the accounted money stock?

More than 30 years ago in a path-breaking article, Leland Yeager devised a means of testing this question.[4] Yeager noted that "many definitions of money can be self-consistent. But no mere definition should deter us, when we are trying to understand the flow of spending in the economy, from focusing attention on the narrow category of assets that actually get spent. . . . Certain assets do and others do not circulate as media of exchange. . . . The medium of exchange can 'burn holes in pockets' in a way that near moneys do not. . . . These are observed facts, or inferences from facts, not mere *a priori* truths or tautologies."[5]

When people try to get rid of excess (unwanted) money, they unwittingly set in motion market machinery that raises the money prices of wealth and income. This activity continues until people have bid up money prices and bid down the value of the money unit to where everyone is content to hold the existing quantity of money at its current value. Money, being an item that appears in all markets, has no single market of its own in which an equilibrium can develop because "the money market" is *all* markets where money is exchanged.[6]

No such process affects near-moneys, which include savings deposits and the other items mentioned above. If people have excess amounts of any near-money asset, they do not spend the excess in all markets. Indeed, they cannot do so because the item is not a money. The adjustment to "too much" takes place in the particular market affected. People who have "too much" savings and loan shares cannot spend the excess in other markets. They

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simply turn in their shares for cash. Interest rates and other variables then adjust to this change in preferences, but no disruptive macroeconomic upheavals occur.[7]

Yeager's discussion provides an unexceptionable means for deciding what to include in "the" stock of money and what to classify as financial assets. The financial items in question, though they are clearly wealth, are *not* money. Excess supplies of them have no pervasive macroeconomic consequences, but work themselves out in specific markets. For the 1920s, currency, demand deposits, and (possibly) time deposits in commercial banks—banks that also issue checking accounts—were exclusively money.

The Monetary Control Act of 1980, however, changed the ball game. It provided for checking privileges against savings and loan shares and savings bank accounts. The spendable money stock then had to include these issues, just as it included commercial banks' demand deposits.

Another means of classifying money stocks is by testing the effects of the different classifiable money stocks on the flow of total spending that becomes realized income. The narrow money stock, M1, which includes hand-to-hand currency and demand deposits adjusted for interbank holdings, is the bellwether. No one doubts their moneyness. Changes in this stock fairly well correlate with changes in total spending. If the other financial assets Salerno wishes to classify as "money" have monetary properties, adding them to the narrow stock of money should improve the more inclusive stock's ability to correlate with changes in gross spending.

A colleague of mine and I carried out an experiment in the late 1960s that used this method.[8] Gross National Product (GNP) data for several reference cycle periods from 1896 to 1966 were our dependent variable. To predict GNP spending, we included the various money stocks noted above.

Our findings were instructive. First, in all non-wartime periods, the correlations between changes in the stock of narrow money, M1, and changes in GNP were very high. Adding time deposits in commercial banks to M1, thus making it M2, did not add significantly to the effectiveness of M1, except for the period 1933–1938. In all other periods, time deposits had negative effects: For the 1920–1929 period, an increase of one dollar in the stock of currency or demand deposits increased total spending by five dollars. An increase of one dollar of time deposits, however, *diminished* total spending by one dollar.

Savings and loan share capital and cash surrender values of life insurance were not even in the ballpark. Increases in their stocks all had negative effects on GNP spending changes. These assets, while wealth, have no monetary properties, and by no scientific standard can one include them in any measured money stock. To insist dogmatically that they are money is to deny epistemological progress from painstaking scientific scholarship.

Federal Reserve Policy Before and After 1933

In my original article in *The Freeman: Ideas on Liberty* (April 1999) I distinguished between the Federal Reserve Banks' gold assets and their holdings of interest-earning assets—their loans, discounts, and advances to member banks. I labeled the gold "Fed Gold," and the other assets "Net Fed." Only the Net Fed assets were under the policy control of the Fed Banks. They could enlarge or reduce this quantity solely by lowering or raising their discount rates.

I reported that overall Fed Bank lending from 1921 to 1929 was decidedly negative. The Net Fed asset total *declined* from $2.16 billion to $1.39 billion, even while the Fed Banks' gold stock was *increasing* from $2.63 billion to $2.86 billion. These data reflect the overall deflationary tendency of Fed policy: Fed Banks allowed their earning assets to decline even as they stockpiled, or "sterilized," the new gold. Without their earning assets (Net Fed), the Fed Banks would have been nothing more than warehouses for bank-owned gold; their policy effects would have been zero.

Bank of England directors, particularly Montagu Norman, persistently tried to get Fed officials to change to an inflationary poli-

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cy so that their job with price levels and exchange rates in England would be easier. However, Benjamin Strong and other top Fed executives resisted.[9]

Salerno's assertion that "During this period, it was the chosen policy of the Fed to lend liberally and continuously to all banks at an interest, or 'discount,' rate below the market rate," is just plain untrue. Fed Bank lending to member banks diminished steadily from 1921 to 1924, and only increased slightly to 1928. In 1921, the monetary base was $6.55 billion, of which Fed Bank lending accounted for $2.16 billion—33 percent. By 1929, the monetary base was $7.10 billion, and the Fed's contribution to that total was $1.39 billion—20 percent.[10]

Unfortunately, Federal Reserve policy remained strongly deflationary despite the bank panics in the early 1930s. When bank panics occurred in earlier eras—1893 and 1907—private clearinghouse associations, which the banks themselves managed, created and issued clearinghouse loan certificates to solvent but temporarily illiquid banks. Recipient banks used this media to meet adverse clearing balances at the clearinghouse, and by this means stopped the hemorrhaging of reserves and collapse of bank credit.[11]

The Federal Reserve System came into existence on the presumption that it would make the clearinghouse issues official and legitimate. The 1929–1933 episode of bank fragmentation and destruction, however, emphasized the difference between privately operated clearinghouses and a regulatory government agency: "The Federal Reserve alternative . . . introduced a discretionary political element into monetary decision-making and thereby divorced the authority for determining the system's behavior from those who had a self-interest in maintaining its integrity."[12] The governmental clearinghouse system, the Federal Reserve System, failed because the decision-makers in the Fed faced no bottom line.

When Salerno gets to the events of 1929–1933, he makes statements that hardly need any formal refutation. In "answer" to my observation that the Fed "monetarily starved the country into the worst economic crisis it has ever experienced," Salerno asserts: "On the contrary, the factors *controlled by the Fed* continued to exercise a highly inflationary impact on bank reserves and the money supply from late 1929 through 1932, as the Fed attempted desperately to ward off the depression precipitated by the termination of the bank credit inflation that it had orchestrated in the 1920s."[13]

This statement contains at least three errors. First, the "factors controlled by the Fed," namely, the interest-bearing debt of member banks to Fed Banks, was at the same trivial value—$1.25 billion—in 1932 that it was in 1927. Had the Fed Banks been "trying desperately to ward off a depression," they would have been lending freely to the member banks on the Bagehot principle.[14] Second, the Fed Banks were *absorbers* of new gold: Their gold stock increased by $700 million, but their net monetary output increased by only $680 million. Third, as I showed above and in my original article, the "inflation" the Fed Banks "orchestrated" in the 1920s was not an inflation but a deflation.

The real bills doctrine—the core belief of what Salerno refers to as "the Banking School"—ruled Fed policy of that era.[15] The economist Clark Warburton explained in one of his excellent articles on monetary policy how Fed "authorities" let this doctrine paralyze their lending largess. In the early 1930s, Warburton noted, Fed Banks "virtually stopped rediscounting or otherwise acquiring 'eligible' paper [that is, real bills]. This was not due to lack of eligible paper. . . . [Fed Banks] did not hold sufficient eligible paper [to extend the necessary credit to member banks] solely because the Federal Reserve authorities had discouraged discounting almost to the point of prohibition."[16]

The data from the Great Contraction (1929–1933) and resulting Depression (1933–1942) disprove Salerno's assertions. From a stable value around 74 (CPI) in the late 1920s, money prices tumbled *8 percent per year* over the next four years to a value of 55.3 in 1933. Yet Salerno insists that the Fed tried to maintain the "inflation" it had initiated. While it was maintaining all this "inflationary" financing during the great purging of

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1929–1933, the price level fell 25 percent, and approximately 9,400 (39 percent) of the commercial banks closed their doors forever.[17] The inability of Fed and Treasury officials to interpret properly their disastrous policies and to make the necessary corrections was as astounding as the event itself.

Federal Reserve-Treasury Policy on Gold and Excess Reserves

I pointed out in the third article on this period, "The Reserve Requirement Debacle of 1935–1938" (June 1999), the factors that most depressed bank credit and the money stock were the complementary policies of raising reserve requirements on member banks and the sterilization of current gold inflows. Those actions plainly continued and enhanced the deflationary thrust of earlier policies. Some economists of the era failed to grasp the full import of the Fed's deflationary effects because they thought only of the central bank's ephemeral effect on interest rates. That same mistaken outlook thrives today.[18]

Bankers were both dumbfounded and shell-shocked. The ones who had survived the bank debacles of the early 1930s were the more conservative members of the profession. Additionally, the experience of survival made them even more reluctant to lend no matter how much "excess reserves" they had.

My conclusion in *The Freeman* article was that the Fed-Treasury gold-reserve requirement policy during 1936–1938 was immensely deflationary. Before the gold could become bank reserves, the Treasury sterilized it. And before the banks could use their existing "excess reserves" to expand credit, the Fed sterilized them by reclassifying them from "excess" to "required." To the banks those "excess" reserves were already required. So redefining them as "required," by doubling required reserve percentages, made that portion of reserves *deficient* in the view of many bankers.

The Fed loosened up monetary policy drastically during the war (1942–1946). The results confirm how readily a policy based on the quantity theory of money could have ended the first symptoms of business contraction a dozen years earlier. Once the Fed's monetary excesses began, the unemployment of the 1930s quickly ended and genuine inflation became the problem. One then wonders: how do "Austrian" economists distinguish a real inflation—one that features greatly expanding fiat moneys and burgeoning price-level increases—from their 1920s "inflation" with its falling prices? And, given the long series of paper-money excesses since 1942, where are the "Austrian" deflations and depressions that would rectify the Fed's monetary increases over the last 55 years? I have in mind many changes I would have made in Fed policy, but the "Austrian" prescription of monetary desiccation that Salerno offers is clearly a "cure" that is worse than the disease.

The late Paul Heyne reviewed a book for *Ideas on Liberty* that the publishers advertised as an "economic handbook for beginners from a Marxian viewpoint." Heyne notes that "Varoufakis [the author], because he does not believe that theories can be either confirmed or refuted by facts, allows himself to make sweeping assertions about what's wrong with the world and what must be done to repair it on the basis of a theory that is far more melodramatic than plausible. Varoufakis quotes none other than Ludwig von Mises in support of the claim that we cannot use facts to test economic theories."[19]

Salerno's arguments on the events and policies of the 1920s and 1930s presume this same methodology. It is also the one Rothbard proudly flaunted. No natural scientist, and no economist who considers his work "scientific," would accept such a constraint. Scientific method must use and does use both inductive and deductive methods for a valid analysis of events. □

1. Joseph T. Salerno, "Money and Gold in the 1920s and 1930s: An Austrian View," *The Freeman: Ideas on Liberty*, October 1999, pp. 31–40. My series appeared in April, May, and June 1999.

2. See Henry Thornton, *The Paper Credit of Great Britain*, ed. with an Introduction by F. A. von Hayek (New York: Rinehart & Co., Inc., 1939), pp. 109–110, 195–98, and David Ricardo, *The Works and Correspondence of David Ricardo*, ed. Piero Sraffa and M.H. Dobb (Cambridge, England: Cambridge University Press, 1953), especially chapters 1, 20, and 27.

3. I treat this issue in "The Classical Search for an Invariable Measure of Value," *The Quarterly Review of Economics and Business*, Spring 1966, pp. 37–44.

4. Leland Yeager, "Essential Properties of the Medium of Exchange," *Kyklos* 21 (1968), pp. 45–69. (Republished in several collections, most recently in *The Fluttering Veil* (Indianapolis: Lib-

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erty Fund, 1997), pp. 87–110. I use this latter source for reference here.

5. Yeager, *Fluttering Veil*, p. 89.

6. Ibid., p. 93.

7. Ibid., pp. 93–96.

8. Richard H. Timberlake, Jr., and James Fortson, "Time Deposits in the Definition of Money," *American Economic Review*, March 1967, pp. 190–94.

9. For a definitive review of Federal Reserve policies and actions during this period, see Milton Friedman and Anna J. Schwartz, *Monetary History of the United States, 1867–1960*, "Gold Movements and Gold Sterilization" (Princeton, N.J.: National Bureau of Economic Research and Princeton University Press, 1963), pp. 279–87. In my first article I wrote, somewhat carelessly, that the Fed wanted to help the Bank of England "achieve and maintain gold payments" (p. 40). But the "help" the Fed offered did not extend to a U.S. price-level increase. It meant only loans and other temporizing measures to the Bank of England.

10. See Richard H. Timberlake, *Monetary Policy in the United States: An Intellectual and Institutional History* (Chicago: University of Chicago Press, 1993), Table 17.1, p. 264.

11. For an extended treatment of the clearinghouse episode, see ibid., chapter 14, "The Central Banking Role of Clearinghouse Associations," pp. 198–213.

12. Ibid., p. 212. Highly restrictive banking laws after the Civil War both provoked and aggravated any chance monetary disequilibrium in the commercial banking sector.

13. Salerno, p. 37; emphasis added.

14. Richard H. Timberlake, "Money in the 1920s and 1930s," *The Freeman: Ideas on Liberty*, April 1999, p. 41 and note 6.

15. Contrary to Salerno's charge, I do not subscribe to this doctrine and never have. See *Monetary Policy*, especially pp. 193, 259–60.

16. Clark Warburton, "Monetary Difficulties and the Structure of the Monetary System," *Journal of Finance*, December 1952, pp. 535–36. I cannot recommend the works of this economist too highly. See especially the book of his collected work, *Inflation, Depression, and Monetary Policy* (Baltimore: Johns Hopkins University Press, 1966).

17. See again my *Monetary Policy*, pp. 266–69, for an account of the public's attempt to convert demand deposits into currency.

18. For a contrary view, see my article "The Fed Sets Interest Rates? It Just Ain't So!" *The Freeman: Ideas on Liberty*, December 1999, pp. 6–7.

19. Paul Heyne review of Yanis Varoufakis, *Foundations of Economics: Beginner's Companion* (Routledge: New York, 1998), *Ideas on Liberty*, January 2000, p. 60.

Inflation and Money: A Reply to Timberlake

by Joseph Salerno

In his reply to my October 1999 *Freeman: Ideas on Liberty* article, Richard Timberlake fails to address or misconstrues most of the substantive issues I raised in my comment on his earlier three articles. Space constraints, however, permit me to respond only to a few of his more important arguments. These involve the evolution of the word "inflation" and the definition of money.

Evolution of the Word "Inflation"

The reader should recall that it was Timberlake himself who, in his first article, described Rothbard as "endowing inflation with a *new and unacceptable* meaning" (my emphasis) in order to "discover" a nonexistent inflation in the 1920s. I spent a substantial part of my article responding to his erroneous claim and documenting that inflation in Rothbard's sense has a long and venerable history in monetary thinking.

Now Timberlake shifts ground and argues that the pedigree of a definition of "inflation" is "largely irrelevant to substantive issues." Whether or not this latter claim is true, he is arguing to a conclusion that does not bear on the issue at hand, an issue that Timberlake himself first raised. But a few sentences later Timberlake shifts ground yet again, now linking Rothbard's definition with that of some nameless "ancient economists" who he alleges "used the term 'inflation' to mean an increase in the stock of paper money *together*

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with an increase in prices." Is Rothbard's definition of inflation a newly invented ploy or an ancient fallacy? Timberlake cannot have it both ways.

Timberlake is also incorrect in asserting that it was only after the invention of price indices in the mid-nineteenth century that economists were able to "describe the value of money as the inverse of money prices" or to "properly distinguish between increases in the stock of money and general increases in money prices." In fact, the earlier British classical economists whom Timberlake cites, namely, Thornton, Ricardo, and Mill accomplished precisely these things without recourse to a price index. As Jacob Viner, the great historian of classical economic thought, pointed out long ago, "When [the classical economists] speak of the value of money or the level of prices without explicit qualification, they mean the array of prices, of both commodities and services, in all its particularity and without conscious implication of any kind of statistical average."[1] In other words, the classical economists recognized that the value of money consisted of the "array" of alternative quantities of particular goods purchasable by the monetary unit, for example, two candy bars *or* one frozen yogurt cone *or* one-tenth of a baseball cap, and so on. If we assume that the monetary unit is the dollar, then each of these quantities of goods represents the inverse of the respective good's dollar price—$.50 per candy bar, $1.00 per frozen yogurt cone, $10.00 per baseball cap. Furthermore, the leading classical economists were insightful enough to recognize that the individual elements constituting the value of money, that is, the reciprocals of particular money prices, were heterogeneous and continually varying in relation to one another. This led some of them to deliberately shun or explicitly criticize the use of a price index, the first of which was developed in England in 1798.[2]

This brings me to Timberlake's mischaracterization of the modern Austrian case against price indices. According to Timberlake, the thrust of the Austrian case is that price indices are "non-subjective." But this is not the Austrian objection at all. Quite to the contrary, Austrian economists, like classical monetary theorists, argue that what exists in *objective* reality at any moment, and what market participants therefore use in their economic calculations, are particular money prices actually paid or expected to be actually paid in the future. As noted above, the value of money is embedded in the *structure* of individual money prices, and cannot be conceived of apart from it. Any attempt to average this structure into a unitary *price level* is completely arbitrary because it entails a subjective choice by the statistician among the variety of available methods for constructing indexes. Nor is such a unitary index for measuring changes in the value of money needed by households and businesses in planning their everyday transactions. For as Ludwig von Mises pointed out:

> A judicious housewife knows much more about price changes as far as they affect her own household than the statistical averages can tell. She has little use for computations disregarding changes both in quality and the amount of goods which she is able or permitted to buy at the prices entering into the computation. If she "measures" the changes for her personal appreciation by taking the prices of only two or three commodities as a yardstick, she is no less "scientific" and no more arbitrary than the sophisticated mathematicians in choosing their methods for the manipulation of the data of the market.[3]

Thus from a substantive standpoint, Rothbard and the Austrians object to the definition of inflation as a general rise in the CPI or GDP deflator because this definition obscures the relative changes within the price structure caused by an expansion of the money supply. In other words, an increase in the money supply will cause prices to rise unevenly, with some rising earlier and to a greater extent than others. Indeed, the very notion of a "price level" is a profoundly misleading metaphor, because it suggests the level of a body of water rising and falling uniformly and instantaneously. The more instructive metaphor is that of a swarm of bees, in which the individ-

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ual bees are never lost sight of as they continually alter their relative positions within the swarm as it changes altitude. In the same manner, as the "price swarm" rises or falls as a result of a change in the supply of money, the relative positions of the individual prices, and therefore of the distribution of individual incomes and demands, undergo continual alteration and remain permanently altered even after the price swarm adjusts to its new height.[4]

The revolution in the price structure that inevitably accompanies any change in the purchasing power of money is instructively illustrated by the experience of the 1920s. As Timberlake recognizes, consumer and wholesale prices gradually declined during this decade due to a productivity-driven increase in the supplies of goods and services that outstripped the increase in the supply of money. However, what he fails to mention is that this expansion of the money supply, as a consequence of its initial injection into credit markets, also increased the prices of capital goods relative to the prices of consumer goods. The relative increase in the prices of capital goods was manifested in the boom in real estate and stock markets, in which titles to aggregates of capital goods are exchanged. In addition, long-term and short-term interest rates, which reflect the differential between capital and consumer good prices, were driven down from 1921 through 1928.[5] Owing to their reliance on a definition of "inflation" that mandates exclusive attention to a nonexistent price level, Timberlake and the monetarists are oblivious to movements in real money prices that crucially affect the economic calculations and plans of entrepreneurs and, therefore, the real production processes of the economy.

Finally, Timberlake invokes a strangely irrelevant "thought experiment" to disprove Rothbard's claim that a major inflation occurred during the 1920s. According to Timberlake, an inflation could not have occurred between 1921 and 1929 because anyone would prefer $2,000 of income in 1929 dollars to the same income in 1921 dollars, given that prices were lower in 1929 than in 1921. While this is true, it is a textbook case of begging the question by assuming what is to be proved.[6] Obviously, if Rothbard's definition is assumed to be wrong from the outset and, therefore, inflation is defined as a general rise in prices, and prices have indeed fallen, then it can be validly inferred that no inflation has occurred. But Timberlake's argument proves nothing against the usefulness of Rothbard's definition of inflation. I could just as easily argue that if the Fed had not "inflated" the money supply during the 1920s, the value of money would have been even higher in 1929 than it actually was and people would prefer $2,000 of income in the 1929 dollars of this counterfactual world to the same nominal income in actual 1929 dollars. This would hardly prove that Timberlake's definition of inflation is useless, though I believe it is for the reasons stated above.

The Definition of Money

In discussing the issue of which items to include in the definition of the money supply, Timberlake refers to Leland Yeager's empirical test for identifying those assets that function as a general medium of exchange. According to this test, when people feel that they are holding too much money they attempt to rid themselves of the excess by spending it on various goods and services, thus causing money prices in these markets to begin to rise. The extra spending and rising prices spread throughout the economy will continue until the value of money has been driven down to the point at which people are satisfied with holding the entire existing stock of money because their anticipated transactions will now require greater sums of the less-valuable money. Thus for Yeager, the money supply consists of those things, such as currency and demand deposits, that are routinely spent and accepted as final payment in all markets.

However, demand deposits do not pass Yeager's test just because checks drawn on them are spendable or because they operate as an independent medium of exchange alongside currency. Rather, demand deposits can be considered part of the money supply because they are interchangeable at par and on

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demand into currency, that is, Fed notes, which in our present system is the ultimate embodiment of the general medium of exchange. But once this is realized, it becomes immediately clear that noncheckable savings deposits at commercial and savings banks as well as the share accounts of savings and loan associations operate likewise as instantaneously redeemable, par-value claims to definite quantities of currency.[7] The fact that the owner of a savings deposit in the 1920s could not spend by directly transferring a portion of his deposit balance to a third party via check but had to walk or drive to the bank to redeem it before making his expenditure is a technical detail that does not affect the essence of the economic transaction. Savings deposits and savings and loan share accounts, no less than demand deposits, therefore, offer unconditional access to immediately spendable dollars and thus meet Yeager's criterion for inclusion in the money supply.

Rothbard clarified this point with the following example. Let us assume that as a result of the development of a sudden and widespread cultural aversion to the number 5 among the nonbank public, five-dollar bills are no longer accepted in exchange. When someone now wishes to exchange some of his five-dollar bills, he must first travel to the bank to convert them into dollar bills of other denominations. Now as long as these bills remain interchangeable at par and on demand into dollar bills of other denominations, no one would have reason to object to their inclusion in the money supply. Indeed, they would pass Yeager's test: thus, if a helicopter were sent forth by the Fed to shower the country with additional billions of dollars in five-dollar bills, money prices and incomes would soon begin a general rise as the populace scrambled to spend their surplus cash balances. But as Rothbard pointed out, savings deposits are in precisely the same situation as the five-dollar bills in this example: other things equal, an increase in their total would create an excess supply of spendable dollars in the economy initiating an adjustment process that lowers the value of money. In fact, in the 1920s bank credit expansion resulted in a disproportionate growth in "time," or savings, deposits vis-à-vis demand deposits, because businessmen were induced by the payment of interest on savings deposits to hold the less active portion of their balances in this type of bank account.[8]

Timberlake offers a second test that allegedly supports his narrower definition of the money supply. According to this econometric test, a particular type of asset is to be included in the definition of the money supply if its inclusion improves the positive correlation between the empirical monetary aggregate and total dollar spending on final goods and services or gross national product. The logic of this test implies that if the addition of the supply of peanut butter to the monetary aggregate being tested improved its "explanation" of total spending, then peanut butter would be considered part of the money supply. But this positivist test is in direct conflict with Yeager's test, which is designed to identify only those assets as money that function *essentially* as a general medium of exchange, that is, which are purchased in anticipation of being resold for other goods in the future. Thus Yeager's essentialist test would exclude peanut butter because, in our economy at least, it is a consumer's good, an excess supply of which results in a fall in its own money price and not directly in an increase in the money prices of other goods. In fact, in the same article that Timberlake quotes from, Yeager strongly criticizes precisely the very positivist approach to defining money that Timberlake defends. □

1. Jacob Viner, *Studies in the Theory of International Trade* (New York: Harper & Brothers Publishers, 1937), p. 314.

2. Ibid., pp. 312–14.

3. Ludwig von Mises, *Human Action: A Treatise on Economics*, Scholar's Edition (Auburn, Ala.: Ludwig von Mises Institute, 1999), pp. 223–24. Mises's point is most recently illustrated in the discussion of how to change the CPI to improve its "measurement" of inflation. Needless to say, the suggested changes, just as the earlier exclusion of food and energy prices on the grounds of their alleged "volatility," are themselves based on the subjective preferences of economists and statisticians. Of course, it is absurd to suggest that American households and businesses discount the recent run-up in gasoline prices in allocating their expenditures just because they are volatile.

4. The suggestion that the concept of a price swarm is superior to that of a price level is due to the brilliant but neglected monetary theorist Arthur W. Marget, *The Theory of Prices: A Re-examination of the Central Problem of Monetary Theory*, 2 volumes (New York: Augustus M. Kelley Publishers, 1966 [1938–1942]), vol. 2, pp. 330–36.

5. Sidney Homer, *A History of Interest Rates*, 2nd ed. (New Brunswick, N.J.: Rutgers University Press, 1977), pp. 354, 372.

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6. Antony Flew, *Thinking Straight* (Amherst, N.Y.: Prometheus Books, 1977), pp. 65–66.

7. As I pointed out in my previous article, savings deposits and S&L share accounts were, for all intents and purposes, effectively convertible into currency on demand. Moreover, just as in the case of demand deposits, after 1934 the par-value interchangeability between savings deposits and S&L share accounts on the one hand and currency on the other was insured by an agency of the federal government. This occurred for credit unions only after 1971.

8. On this neglected aspect of the 1920s inflation, see C. A. Phillips, T. F. McManus, and R. W. Nelson, *Banking and the Business Cycle: A Study of the Great Depression in the United States* (New York: Arno Press, 1972 [1937]), pp. 95–101; Benjamin M. Anderson, *Economics and the Public Welfare: A Financial and Economic History of the United States, 1914–1946*, 2nd ed. (Indianapolis: Liberty*Press*, 1979), pp. 139–43. Not coincidentally, the authors of these two volumes were heavily influenced by Austrian monetary and business-cycle theory.

Final Comment on Salerno's Monetary Program

by Richard H. Timberlake

I am not going to re-argue the points of difference between Salerno's arguments and mine in this final rejoinder. The reader must decide for himself which parts if any of our respective views are most logical and most useful in dealing with the events under scrutiny. I find that nothing in Salerno's final account refutes anything I have argued. I must, however, correct a few of his fallacious notions.

Salerno and I share much common ground in our advocacy of free markets and other characteristics of a society ruled by individual preferences and minimal constitutional government. Clearly, however, we speak—perhaps imperfectly—for different tools and different approaches on how to analyze monetary disturbances, especially the "Big One" of 1929–1941. Salerno would even change the time of this disequilibrium to 1921 and on, perhaps to the present. Indeed, if his (and Rothbard's) doctrine is to be consistent, financial markets have not been stable since 1858. For not since the Civil War has the money stock been ruled exclusively by, and based on, the presence of the precious metals. Thus the Great Contraction and Great Depression should have been one of only many great contractions and great depressions over the last five generations. So why was the period 1929–1941 unique? Why was this particular business depression so deep, so stubbornly protracted, and so resistant to the "therapy" of monetary authorities?

Salerno notes that I fail to mention that the increase in the money supply during the 1920s "also increased the prices of capital goods relative to the prices of consumer goods." This disparity, he claims, set in motion a boom in real estate and stock market prices—the "Austrian Theory of the Business Cycle" (ATBC). Then, he adds, all interest rates "were driven down," presumably by the "increase" in Fed money.

This compounding of assertions is wrong from beginning to end, and is not verified by any empirical studies. Fed-created money declined all through this period, while gold-based money increased nominally. And did the prices of consumer goods decrease relative to the prices of capital goods? Where is the empirical measurement of this phenomenon? What are the norms for judging the differences? When money has entered the economy from whatever sources during business fluctuations in the past, has there been a dis-

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parity between the increases in prices of capital and consumer goods?

I raise these questions because those who profess "Austrian" economics have largely, if not exclusively, failed to raise or answer them. They assert logical possibilities, such as the ATBC, but offer no empirical evidence to substantiate them. In spite of the many worthwhile values in Austrian doctrine, therefore, their stock among conventional thinking economists is not high, especially with reference to monetary affairs.

Salerno also claims that I and "the monetarists are oblivious to movements in real money prices." How he can seriously make this charge is more than I can understand. In fact, the most important use of price indexes is to distinguish between money prices and real prices. Anyone who examines my work, or that of any monetarists, will see that real values bulk large in our writings.

In assessing the question of what to include in "the" stock of money, I offered the Yeager test: Do disruptions in the supply of the alleged money work themselves out in a particular market without macroeconomic disruptions, or does a large variation in the supply of the alleged money spread to all (or many) other markets? Clearly, this test washes out savings deposits, savings and loan share capital, and cash surrender values of life insurance companies as moneys. These items, while wealth, have no monetary properties—no more so than real estate and common stock holdings. Here again, however, is a question that can be tested empirically. I did so once upon a time, and established some answers. These answers were not written in stone; they can be altered or refuted, but not by laid-back theorizing from some supposedly "irrefutable" doctrine.

The three articles I wrote for *The Freeman: Ideas on Liberty* last year concluded that the Great Contraction and Great Depression were results of badly conceived central bank and Treasury policies. A "good" central bank, such as the Federal Reserve System is today, would never have allowed that debacle. Nonetheless, this conclusion does not excuse the institution of central banking generally and its interference in the money-creating process. In other research I have done I have found that the privately designed and operated "central bank"—the informal system of clearinghouse associations—did much better in operating as a lender of last resort. In fact, the Federal Reserve System was meant to be the government designed clearinghouse system and failed because private incentives for doing the right thing at the right time were lacking.

Yet again, the clearinghouse system only came into existence because of the rigidities and complications that government banking policies forced on the banking system. Were the money industry as free to innovate and produce as the computer industry, it is very probable that we would see the end not only of Great Contractions and Great Depressions, but also even those of minor magnitudes. I look forward to such a day. □

Read the entire Timberlake-Salerno exchange online at www.fee.org.

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Economics

Take This Job and Shove It, at the Margin

Many believe that pay is overemphasized and much too unequal in market economies. Supposedly, most people enjoy working, and so while they have to be paid to survive comfortably, they don't have to be bribed with bonuses tied to performance to do a good job. Indeed, psychological experiments indicate that the intrinsic interest people have in doing a task declines when they are paid for doing it.

And why the large differences in the amounts different people are paid? Since people enjoy working, big pay differences aren't needed to overcome the unpleasantness of working, at least not in most jobs. Anyway, how can you explain that people who have the most enjoyable jobs (such as professional athletes, successful entertainers, and corporate executives) typically receive far larger incomes than those who have the least enjoyable jobs (such as custodians, trash collectors, and coal miners)? Also, the argument continues, pay differentials reduce productivity by shifting the emphasis in the workplace from cooperation to competition.

Those arguments can be persuasive at first glance, as they are in a very readable book by Alfie Kohn.[1] But the case is seen to be seriously flawed when examined with an understanding of basic economic concepts, such as marginalism.

Dwight Lee is Ramsey Professor at the Terry College of Business, University of Georgia, and an adjunct fellow at the Center for the Study of American Business at Washington University in St. Louis.

Economists are often criticized for assuming that workers have to be paid because people like leisure and dislike work. For example, Kohn (p. 131) claims, "Economists have it wrong if they think of work as a 'disutility' . . . something unpleasant that we must do in order to be able to buy what we need, merely as a means to an end." In fact, economists have no problem admitting that most people enjoy their work. But they also recognize some other important considerations regarding work.[2]

If a person enjoys one job, he will also enjoy others. So what job should he take? Clearly his preferences for the type of work he most enjoys should be considered. But so should the preferences of consumers who will value the contribution of a worker more in some jobs than in others. Fortunately, consumers can communicate their preferences effectively through their purchases, which translate into greater demand and higher incomes for workers who produce the most valued products. This communication would be censored by government policies that arbitrarily reduced the pay differentials generated in labor markets. Such censorship would reduce not only the value of what workers produce, but their freedom. Workers can be allowed to choose a job that is less productive, but more enjoyable, only when they are held accountable through lower pay for the reduction in value created for consumers.

In the psychological experiments cited by Kohn that show interest in performing a task

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declining when people are paid, it makes little difference what tasks are being performed. In the economy, attracting workers into the right jobs is crucial and requires pay differentials that critics like Kohn find objectionable. Even if the pay differentials generated by the market do reduce the performance of workers (a doubtful proposition, as we are about to see), it is better having people working at less than full capacity at valuable tasks than at full capacity at useless tasks.

Economists also recognize that while people generally enjoy their work *in total*, most jobs are a pain *at the margin*. Even if you get tremendous satisfaction from your job, the *marginal* satisfaction can be very low, in fact negative. Well before the work day is over, most of us are tired of the grind and would love to leave work early and do something else. We would like to tell the boss, "Take this job and shove it, *at the margin*." People put in eight hours of diligent effort because there is a financial inducement to do so.

In fact, the ability of consumers to communicate their preferences to workers through differential pay acts to guarantee that workers receive marginal "disutility" from their jobs. The value a worker is contributing to consumers by remaining on the job is positive even though the marginal value he receives from working longer has declined to zero and is about to become negative. Since consumers can communicate through additional pay that the value to them is greater than his cost of staying on the job, he continues working. The additional pay compensates him for the marginal "disutility" of working as long as that disutility is less than the marginal value he is creating.

Even popular entertainers and athletes, who receive enormous total satisfaction from their jobs, perform in late-night shows, take road trips, and put in extra hours rehearsing and practicing when they would rather be doing something else. But because their performance is valued so highly by consumers who communicate that value with extremely lucrative compensation, they put in the extra hours.

I am not claiming that compensation is always tied directly to worker output. That is not always practical. But even when employees are being paid about the same, even though some are better workers than others, long-term considerations can still connect pay to performance. Those who miss too much work are dismissed; less productive workers are more likely to be laid off in business downturns; and more productive workers are more likely to be given better work schedules and promoted. Responding to consumers effectively requires that firms have compensation arrangements that, over time, connect pay to contribution.

Importance of Cooperation

Obviously cooperation is important in the workplace. But few things can reduce cooperation more than the perception that compensation isn't tied to contribution. There is a strong temptation for workers to shirk, at the margin (and it can be a wide margin), even when they enjoy their jobs, if they don't see a financial reward for diligent effort. Even assuming that most workers were willing to put in a full day of responsible work without the incentive of pay, a few will always take advantage of the opportunity to shirk if there is no penalty. This will be noticed by the dependable workers, who find their effort harder and less productive because of the shirking of the few, and who will begin to feel like suckers since they are receiving no more than the slackers. So a few more will decide it is better to be a shirker than a sucker, increasing the temptation of the rest to slack off. The result is a destructive cycle of shirking that undermines productive cooperation among workers.

I am not arguing that money is the only thing that motivates workers. Also important are such things as respect from supervisors, an uplifting sense of mission, and a feeling of comradeship. But the effectiveness of these considerations will soon crumble without a reasonable connection between pay and performance. □

1. Alfie Kohn, *Punished by Rewards* (Boston: Houghton Mifflin Company, 1993).

2. See Richard B. McKenzie and Dwight R. Lee, *Managing Through Incentives* (New York: Oxford University Press, 1998), chapter 20, for a more detailed discussion of the argument in this column.

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CAPITAL LETTERS

Chosen Words Have Meaning

To the Editor:

I have enjoyed and appreciated Wendy McElroy's articles in the *Ideas on Liberty* for quite some time, but I must take issue with her fundamental premise in "Constitutional Intentions" (June 2000).

Let me quote the first paragraph in order to refer more clearly to it: "A question frequently arises in disputes about how to interpret the U.S. Constitution: What was the intention of those who framed the document? This question contains an invalid assumption. It assumes that those who drafted the Constitution at the 1787 convention and those involved in the subsequent debates were of one mind and intent."

The balance of the article deals for the most part with the many minds and many intents of the many types and persuasions of people in the various colonies as to whether the Constitution, as drafted, should be ratified, and if ratified, what its effects would be. [It also deals] with the large amount of compromise involved in its development. But these things are not . . . germane to the questions, What is the meaning of the words in the various provisions of the Constitution, how should they be interpreted in practice, and how were these questions addressed at the time of the convention and ratification? These are the questions, I believe, in the minds of those who look to "the intention of those who framed the document."

Those who look to original intent do not deny there was considerable and frequently passionate disagreement as to whether the Constitution, as written, should be ratified. Nor do they deny that both the content, and the specific wording to express that content, were the result of compromise upon compromise in the convention. They are also aware that there was very careful deliberation on the precise wording to be used to convey the ultimately decided-upon content.

But I think they would tend to hold that there was some significant degree of agreement among the people of the colonies as to the intended meanings of the words in the Constitution as hammered out in the convention, and that these meanings were clarified considerably in the subsequent debates, in the writings of people like "Publius" and others, in practice following ratification, and in court interpretations and legal commentaries in the early years of the Republic. [Seekers of original intent] therefore [believe] it is valid to consider what those common interpretations of the intended meanings of the provisions were at time of ratification and in the early years of the Republic. Because if we can change the meanings of words and provisions in our foundational documents at will as years pass, what have we to build upon but shifting sand?

I feel Ms. McElroy has not spoken in her article to this issue of commonly understood meanings of words and provisions in the Constitution at the time of development and ratification. . . .

She goes on to say, "Rather than search for any one interpretation . . . , it is productive to explore the compromises reflected in the document." But the words and provisions of the Constitution are legal language, and legal language is, or at least should be, subject to precise, and at least some would hope, unchanging interpretation. The delegates understood it to be legal language and that it would be binding if ratified, and I for one believe, based on my study, that they sought carefully and deliberately (all the more so because of their divisions and suspicions) to use wordings which would not be subject to many interpretations. Ms. McElroy implies that it is fruitless to

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attempt to understand what was the commonly understood meaning of particular words and provisions in the Constitution to those who signed and those who debated and ratified it. But if that is the case, does it have, or has it ever had, any meaning at all except as a symbol, like the Statue of Liberty, which after all needs no words to convey its meaning?

—PAUL C. KAUTZ
Maynard, Mass.

Wendy McElroy replies:

I would like to thank Mr. Kautz for his thoughtful response to my article "Constitutional Intentions." I think our key difference is that he approaches the Constitution as a legal document and thus states "the words and provisions of the Constitution are legal language, and legal language is . . . subject to precise . . . unchanging interpretation." I approach the Constitution as a political document under a constant debate that often introduces the intentions of the drafters and ratifiers as "evidence" to support a particular interpretation. For example some anti-gun advocates insist that the Second Amendment's opening words—"A well regulated militia being necessary to the security of a free state . . ."—reveal an antiquated intention to preserve militias and should not be used to protect individual gun ownership. My purpose in the article was to suggest shifting the political discussion away from the original intention behind the Constitution's words in order to focus on: (1) the principles they were meant to embody and (2) the political problems they sought to address.

I do not generally take a legalistic view of the Constitution, for a number of reasons. First, I am not a legal scholar. Second and perhaps more important, I do not consider the document to be legally binding on anyone. Lysander Spooner opens his work *No Treason* with the words, "The Constitution has no inherent authority . . . unless as a contract between man and man." He observes that those who consented to the Constitution are dead and their agreement had "no natural power or right to make it obligatory upon their children." Mr. Kautz is quite correct that the Constitution is a legal document in the sense that it was adopted and has been enforced by government, but this tells me nothing about whether it is inherently just or politically practical.

Third, I tend to emphasize principles rather than wording because, unless the principles are entrenched, the wording will protect very little. You might well respond that how principles are worded is inseparable from what they are, and this is a compelling point. With the Constitution, however, I believe the wording has been over-emphasized.

Fourth, from a political perspective, I have reservations about a precise legalistic interpretation of the Constitution. In some instances, I prefer absolute adherence to every syllable written; for example, the First Amendment—"Congress shall make *no* law. . . ." Yet the logic of this approach does not allow me to argue against aspects of the Constitution of which I am less fond.

In short, we have an interesting difference of approach. However, I think we are probably in accord on the main purpose of "Constitutional Intentions," which was to draw attention away from the intentions of the Constitutional Convention and onto a more substantive matter—whether that matter is the wording or the principles.

We will print the most interesting and provocative letters we receive regarding *Ideas on Liberty* articles and the issues they raise. Brevity is encouraged; longer letters may be edited because of space limitations. Address your letters to: *Ideas on Liberty*, FEE, 30 S. Broadway, Irvington-on-Hudson, NY 10533; e-mail: iol@fee.org; fax: 914-591-8910.

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IDEAS ON LIBERTY
SEPTEMBER 2000

"An Enemy Hath Done This"

"Government measures . . . give individuals an incentive to misuse and misdirect resources and distort the investment of new savings."
—MILTON FRIEDMAN[1]

Several months ago, I had the opportunity of speaking before a Miami chapter of Legatus, a group of Catholic business leaders organized originally by Tom Monaghan, founder of Domino's Pizza. The topic was the outlook for the stock market, which had reached sky-high levels and by any traditional measurement appeared extremely overvalued. Even many experienced Wall Street analysts recognized that a bear-market correction or crash was inevitable and necessary. As the old Wall Street saying goes, "Trees don't grow to the sky." Indeed, in the spring the stock market took a well-deserved tumble.

What is the cause of this boom-bust cycle in the stock market? Does capitalism inherently create unsustainable growth? Is the bull market on Wall Street real or a bubble?

The Parable of the Wheat and the Tares

To answer these questions, I applied Jesus' parable of the wheat and the tares (Matthew 13:24–30) to today's financial situation.

Jesus tells the story of a wheat farmer whose crop comes under attack by an unknown assailant. In the middle of the night this enemy sows tares (weeds) in his wheat fields. Soon the farmer's servants discover that the farmer's crop appears to be twice the normal size. Yet the master realizes that half the crop is fake—weeds instead of wheat. But he warns his servants not to tear out the weeds for fear of uprooting the good shoots; they must wait and let the wheat and the tares grow up together until harvest time. Months later, the wheat produces good grain, while the tares are merely weeds and provide no fruit. The servants pull out the weeds and burn them, and store the grain in the barn.

The parable is imminently applicable to the recent wild ride on Wall Street. In today's robust global economy, the wheat represents genuine prosperity—the new products, technologies, and productivity generated by capitalists and entrepreneurs. It represents real economic growth and when harvested, reflects a true higher standard of living for everyone. Under such conditions, stock prices are likely to rise.

On the other hand, the tares represent artificial prosperity that bears no fruit in the end and must be burned at harvest time. Where does this artificial growth come from? The central bank's "easy money" policies! The

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Fed artificially lowers interest rates and creates new money out of thin air (through open-market operations). This new money, like regular savings, is invested in the economy and stimulates more growth and higher stock prices—higher than sustainable over the long run.

Who is the enemy who sows artificial prosperity? Alan Greenspan! (Or, to be more accurate, central bankers.) The money supply—which is controlled by the Fed—has been growing by leaps and bounds, especially since the 1997 Asian crisis.

But there is no free lunch, as sound economists have warned repeatedly. At some point, the harvest time comes and the wheat must be separated from the tares. This is the crisis stage, where the boom turns into the bust. Harvest time in wheat is fairly easy to predict, but not so in the economy. Clearly economic conditions are heating up, as measured by asset inflation, real estate prices, the art market, and recently the Consumer Price Index. At some point, a "burning" of excessive asset values in the financial markets must occur. As Ludwig von Mises stated long ago, "if a brake is thus put on the boom, it will quickly be seen that the false impression of 'profitability' created by the credit expansion has led to unjustified investments."[2]

Lesson: Globalization and supply-side free-market policies have justified genuine economic growth and higher stock prices over the past two decades, but "easy money" policies have at the same time created an artificial boom and "irrational exuberance" on Wall Street. Ignore this lesson at your own peril. Remember the parable of the wheat and the tares! □

1. Milton Friedman, *Capitalism and Freedom* (University of Chicago, 1962), p. 38.

2. Ludwig von Mises, "The 'Austrian' Theory of the Trade Cycle," in *The Austrian Theory of the Trade Cycle and Other Essays*, compiled by Richard M. Ebeling (Auburn, Ala.: Ludwig von Mises Institute, 1996), p. 30.

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BOOKS

The Global Education Industry: Lessons from Private Education in Developing Countries

by James Tooley

Institute of Economic Affairs • 1999 • 136 pages • $14.00 paperback

Reviewed by Antony Flew

After all the privatizations of the Thatcher years, the British-maintained school system is one of the two largest industries that still remain under state ownership and control. (The other is the National Health Service.) Both are effectively monopolistic and therefore liable to all the notorious faults of monopolies, particularly those run by the government. State education in Britain is not strictly speaking a monopoly because the private provision of educational services is permitted and exists on a relatively small scale. But is there any anti-monopoly legislation in the world that would not be activated if a firm achieved a market share of over 90 percent and kept it through a policy of predatory *non*-pricing?

James Tooley, the author of the present work, opened his campaign for the privatization of educational institutions in 1995 with the publication of his first book, *Disestablishing the School: Debunking Justifications for State Intervention in Education.* His second book, *Education Without the State* appeared a year later. Those works firmly established Tooley's credentials as an educational radical and earned him the enmity of the education establishment.

The current book was initiated, as we are told in the foreword, by "the International Finance Corporation (the private-sector arm of the World Bank Group)," which "had become aware of the potential to participate in private sector educational investments"—most especially in developing countries. What an unexpected development, given the World Bank's usual inclinations to support state institutions.

The findings of this study are astonishing and should prove invaluable to all of those in the United States who are working to privatize and introduce competition into the provision of education services. In Brazil, for instance, there are seven or eight large chains of private schools, several of which also run universities and sometimes educational television stations.

Not only is the private sector large in Brazil, but it is also strikingly innovative. The most dramatic example of this is provided by the COC chain. For fees of about $4,800 a year, it provides each student with a specially devised desk with a fold-away computer terminal networked to CD-ROMs, the Internet, and the teacher's "smart-board," a device that enables the student to take home a copy of all the teacher's blackboard writings on a floppy disk.

An example of the willingness and versatility of educational enterprisers comes from India, where computer training in the state universities is poor, producing graduates who are unemployable in today's computing industries. Private enterprise in the form of NIIT (the National Institute for Information Technology), however, offers superior training in its 400 campuses around the country, and employers now regularly state in their job advertisements that they are seeking a GNIIT—a graduate of NIIT.

Two other features of NIIT are especially instructive. First, because of the need to earn a profit, NIIT is acutely aware of the value of time and space. On NIIT campuses, all rooms and computers are in use constantly from morning to night—very different from state institutions! Second, NIIT has two research departments devoted solely to education. Their performance indicators are publications in research journals and attendance at conferences. NIIT is convinced that the work of their researchers will pass the test of the market, and if not, changes are bound to be made. Again, how different from the "research" usually done by academics in government universities.

After his chapter surveying the development of private education alternatives in 13 developing countries, Tooley proceeds to chapters on "Factors for Success," "Equity

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Issues," "Regulation and Investment Climate," and "Conclusions and Policy Proposals." In "Equity Issues," we are unsurprisingly told that for-profit suppliers in developing countries, as in the developed, mainly serve the middle and upper classes. But in developing countries there are also some services geared toward the poor.

Tooley notes "how total public spending on education in low-income countries typically favours the affluent, and can often be a subsidy from the less well off to the higher income groups." Indeed it can, as it tends to be in high-income countries too. But if the private market for education continues to develop, with more and more people paying for just the education they choose, the "rob the poor to give to the rich" phenomenon will dissipate.

In helping to undermine the intellectual support for government education and, in the current book, demonstrating that private enterprise is providing superior education alternatives for people around the globe, James Tooley has done truly valuable work. □

Antony Flew is emeritus professor of philosophy, University of Reading, England.

Reflections on a Ravaged Century

by Robert Conquest

W. W. Norton • 2000 • 317 pages • $26.95

Reviewed by George C. Leef

Several years ago, R. J. Rummel's book *Death by Government* documented the horrifying numbers of people killed by government during the twentieth century—more than 100 million. Governments have always been the leading cause of violent death, but in the last century, the toll far surpassed anything previously. Why?

In his new book *Reflections on a Ravaged Century*, historian Robert Conquest tries to find the answer. Ideas motivate men, and the terrible fact is that, as he writes, "humanity has been savaged and trampled by rogue ideologies." The author sets out to show "how and why these disastrous mental distortions arose, how and why they came to motivate movements, parties and states." One can scarcely imagine a more important project, and Conquest has performed brilliantly.

Conquest is best known as a historian—arguably *the* historian—of the Soviet Union. Most of his 20 books have been devoted to a clear-eyed exposition of the facts about the regimes of Lenin, Stalin, and their successors. While others were evading the facts or making excuses for the unspeakable barbarity of those tyrants, Conquest insisted on the unvarnished truth. Read, for example, *The Harvest of Sorrow* for his account of the deliberate famine Stalin brought about in the Ukraine, which claimed several million lives without firing a shot.

Lenin, Stalin, Hitler, Mao, Castro, Pol Pot, Idi Amin, and dozens of other villains brought misery and death to millions. They did it by exploiting the power of ideas. Conquest writes, "The book's general theme is that any concept given anything like absolute status becomes not a guide to action but an abstraction whose imposition on reality reveals an incompatibility, as engineers say of parts that do not fit, and that can only be made to fit by main force, and even then ineffectively or ruinously." The sword and gun alone do not enable tyrants to kill and enslave on a vast scale. Ideas, *very bad ideas*, are necessary. The title for the first section of the book sums things up beautifully: Mindslaughter.

But what accounts for the ideological frenzies of the twentieth century? Conquest's insights are legion.

Part of the explanation is that "great causes" provide many people with "an excuse for behaving badly," giving the actor "the right to dishonor" (here quoting Dostoyevsky). Sadly, civilization is a thin and uncomfortable veneer that is easily cracked, releasing the most vicious behavior. Marxism, fascism, and the like provided the necessary excuse, and the KGB, Gestapo, and similar organizations had no trouble filling their ranks.

Another element of mindslaughter is the idiotic idea of collective guilt. When not in the thrall of some ideology, most humans would laugh at the idea that people can be

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guilty of something simply because of some characteristic of theirs. But during the twentieth century that idea took root and grew profusely. Stalin ordered the arrest and deportation of millions of peasant farmers (the kulaks) for no other reason than that they owned some private property and therefore were the "class enemy." The servile Stalinist writer Ilya Ehrenburg explained that "Not one of them was guilty of anything; but they belonged to a class that was guilty of everything." Lots of "useful idiots" (to use Lenin's phrase) fell for that line.

Among the intellectuals, totalitarian arguments were especially potent. Conquest writes with contempt for the American, British, and French writers and academics who served as unpaid propagandists for the tyrants. In an especially penetrating chapter titled "The Answer Is Education," he bemoans the tendency among bright young people to become unthinking devotees of those rogue ideologies: "Often at the age of eighteen or twenty, a student meets a glittering general Idea and, far from feeling any responsibility to submit it to serious questioning, henceforward follows it like a duckling imprinted with its mother."

Reflections is not just a backward-looking book as its title would indicate. Conquest also peers into the future and is not altogether pleased with what he sees. In the chapter "The Europe Idea," he examines the mania for a European megastate. He envisions no benefit but the considerable cost of another layer of bureaucratic intervention. "More rules mean more bureaucrats," he observes, and that "the more numerous the bonds, the more difficult they will be to get out of." Exactly.

The only part of the book that I find unconvincing is the final chapter, "A More Fruitful Unity." Here Conquest proposes a hazy English-speaking "unity" encompassing the United States, United Kingdom, Canada, Australia, and New Zealand. Why we need a supra-national entity is never explained. Free people will form whatever "unities" suit them. It's hard to see how an "English-speaking Union" could do anything to expand the liberty of the people living under it. Almost inevitably, it would diminish liberty as still more officials do what officials do: spend other people's money and invent more work for themselves.

Despite that quibble, this is a book to savor. □

George Leef is the director of the Pope Center for Higher Education Policy at the John Locke Foundation and book review editor of Ideas on Liberty.

The Economic Consequences of Rolling Back the Welfare State

by A. B. Atkinson

MIT Press • 1999 • 228 pages • $25.00

Reviewed by David L. Littmann

It took America's professional politicians little more than three decades to spend more than $5.5 trillion on welfare programs for their constituents. Looking back, we know the results have not been pretty: work incentives were stood on their head by moral hazards created by government largess. Millions of able-bodied people have been trapped in poverty and dependency despite our record-setting economic expansion.

Now along comes A. B. Atkinson, warden of Nuffield College, Oxford, with his book, *The Economic Consequences of Rolling Back the Welfare State*, warning advocates of welfare reform and rollback of the untoward outcome of such policy reversals. The book, a compilation of the author's lectures, revisits supposedly "settled issues" in an effort to convince us that it's economically beneficial to have a welfare system. Really.

Atkinson clearly has a soft spot for the totality of the welfare state, but he concentrates on two pillars of welfarism: state pensions (Social Security) and unemployment insurance. "Weakening" those pillars could, he worries, have regrettable economic consequences. It is a position worth contemplating. In any objective inquiry it is useful to analyze the economic effects associated with policy changes, especially those programs carrying immense entitlement dollars.

The author devotes much of his book to warning readers and fellow economists of the

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unintended consequences that might accrue from policies that remove worker security or incentives to remain idle. That discussion is a curiosity unto itself: How complete is an analysis that concentrates on the supposed costs of eliminating our "social safety nets" while ignoring the costs of maintaining them? That is Atkinson's blind spot.

He argues that Social Security and unemployment insurance provide "universal reduction in the uncertainty faced by individuals." The trouble with that view is that there are alternative means for individuals to reduce risk that provide greater security than reliance on government. Transfer payments, he says, tend to "even out differences in life's chances" and promote "equity between generations and to redress inequality by race, gender, or health status." Yes, we know that egalitarian programs make people like Atkinson feel good, but that is not the same as showing that they produce net economic benefits.

Atkinson also relies on the old warhorse that welfare payments (especially unemployment insurance) are "automatic stabilizers" that will give us "economic stimulus" in times of recession. Of course, the notion that government spending—shifting money from one set of pockets to another—ever stimulates the economy is one that has been severely criticized, but the author accepts it as an article of faith. Finally, in his biggest argument, Atkinson says that doing away with welfare might make workers "demotivated" because they would feel less secure. Insecurity, to the contrary, is a strong motivator, as evidenced by the tremendous work ethic of Americans of a century ago, when we had no government "safety net."

At least Atkinson causes one to think about welfare. Many welfare state programs have institutionalized paternalism. Human beings will behave like children if treated like children. After a generation or two of such treatment, do we really expect recipients or purveyors of such benefits to enthusiastically embrace change? All changes have their adjustment costs, but we ought not adopt a myopic time horizon when judging the worth of policy reform. Atkinson's analysis has this proclivity. A more complete study would incorporate the long-run employment, income, and financial consequences of not removing the moral hazards associated with the welfare state.

Another difficulty is present throughout the text. Atkinson equates "trade union" wages with "good jobs" and generally ignores jobs invisibly destroyed in the process of union efforts to promote protectionist legislation.

Concluding his rather one-sided survey of the arguments for and against welfare programs, Atkinson writes that "There are still grounds for agnosticism." One is tempted to reply, "Welfare states have guaranteed the impoverishment of spirit and pocketbook alike; get over it!" □

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Property and Freedom

by Richard Pipes

Alfred A. Knopf • 1999 • 384 pages • $30.00

Reviewed by Yuri Maltsev

Richard Pipes is professor emeritus of history and former director of the Russian Research Center at Harvard University. Pipes has also had an extensive career in government, serving as director of East European and Soviet affairs in President Reagan's National Security Council. He is the author of several books on the Russian Revolution, including the seminal *Three "Whys" of the Russian Revolution*.

Significantly, Pipes was among the very few Western experts on Soviet socialism who were not charmed by the subject of their study and had a realistic view on the future of socialism. This view, ridiculed by liberal Sovietologists as "blind anti-communism" was vindicated by modern history.

Property and Freedom differs in subject from Pipes's previous books. Yet it grows naturally out of his lifelong research. "From the time I interested myself seriously in Russia, I became aware that one of the fundamental differences between her history and that of the other European countries lay in the weak

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development of property," he writes. "The idea occurred to me some forty years ago that property, in both the narrow and broad senses of the word, provides the key to the emergence of political and legal institutions that guarantee liberty."

First, Pipes analyzes "The Idea of Property" in classical antiquity, the Middle Ages, seventeenth-century England, and eighteenth-century France; the attack against it by socialists, communists, and anarchists; and the status of the idea at the end of the twentieth century. Then he describes the "Institution of Property" as it evolved from possessiveness among animals, children, primitive peoples, and societies of hunters and gatherers to the emergence of property in land, and the relation between the institution of property and political organizations especially in medieval England and "patrimonial Russia."

The rise of the Western world coincided with the rise of the idea and the institution of property rights. Wherever property rights were secure and stable, growth of economic activity occurred. England had a long respect for property rights. Beginning in the twelfth century with Magna Carta, the process was set in motion for the elimination of arbitrary, random government. The people were freer to use their property for their own purposes, and as they did so, the nation began to emerge from the economic torpor of the Dark Ages.

The most interesting parts of the book are on Russia. Summarizing the drama of Russian history, Pipes writes: "Prior to 1991, Russians and the nations on which they imposed their rule enjoyed few civil rights and (with the exception of the single decade 1906–17) no political rights. In the age of absolutism, Russia's sovereigns exercised authority in a more absolute manner than their Western counterparts; in the age of democracy, Russia clung to absolutism longer than any other European country. And during the seven decades of Communist rule, she produced a regime that deprived her people of liberties to an extent previously unknown in world history."

Communist Russia was the first country to officially abolish property rights, which were declared "a sanctification of capitalist oppression and exploitation." The results can be considered as the worst tragedy experienced by humanity. It is beyond the abilities of economic analysis to calculate the opportunity cost of the socialist experiment in Russia, but the human toll is estimated by Russian writer Aleksandr Solzhenitsyn at over 60 million people who perished during Stalin's collectivization, purges, campaigns against "unearned" incomes, and other devilish experiments.

The enormous suffering of people in Russia and the other socialist countries is a powerful warning against socialism, statism, and interventionism in the West because the "most audacious attempt in human history to abolish private property has ended in disaster. It is unlikely to be repeated as long as the memory of that calamity remains fresh."

Unfortunately, the majority of people scarcely understand the importance of property rights. "The trouble," observes Pipes, "is that because schools fail to teach history, especially legal and constitutional history, the vast majority of today's citizens have no inkling to what they owe their liberty and prosperity, namely a long and successful struggle for rights of which the right to property is the most fundamental. They are therefore unaware what debilitating effect the restrictions on property rights will, over the long run, have on their lives." □

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Plagues of the Mind:
The New Epidemic of False Knowledge
by Bruce S. Thornton
ISI Books • 1999 • 223 pages • $24.95

Reviewed by Charles Stampul

Every generation wants to believe that it will know more than the previous one, and this knowledge will lead necessarily to material and spiritual improvement and the elimination of the moral and physical evils from which humanity has suffered for ages. Although faith in progress has enabled people

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to achieve great things, it has also led people to believe that there is almost no problem that can't be solved and no risk that can't be eliminated. Furthermore, progress has caused people to overlook the reality that all decisions involve tradeoffs and has fostered a perspective regarding misfortune that our ancestors would have considered childish. Many have been led to believe that if only government and businesses took appropriate precautions, most tragedies and accidents would be prevented and diseases would be eradicated. As a result of this conviction, they look to government for protection from everything from economic stagnation to beach erosion. How did we get that way?

In *Plagues of the Mind*, Bruce Thornton, professor of classics and humanities at Cal State Fresno, traces unrealistic expectations back to the Enlightenment. This period of discovery, and its promise to improve the human condition, created the hope that through knowledge and reason all forms of suffering could be conquered. Although a great deal was accomplished during this period, aspirations for a more just world went unrealized. As a result, people began to doubt the value of knowledge and reason. They abandoned the scientist as a source of inspiration and turned instead to the artist. But Romanticism, demoting reason and extolling "feelings," did not keep wars from breaking out, disasters from striking, and people from starving.

Today those who hope to eliminate suffering and hardship embrace what some cultural critics have called the therapeutic vision. Thornton describes this vision as "an unholy alliance of Enlightenment and Romantic assumptions," which "has created expectations for human life that are totally unrealistic and doomed to disappointment." In Thornton's view, the therapeutic sensibility "encourages false knowledge: it creates not just unattainable expectations of happiness, but also various pseudoscientific techniques and procedures supposed to deliver on the promise."

Psychotherapy, the most widely used of those techniques, has, Thornton argues, created a nation of helpless victims. His attack on the practice seems to me rather overdone. True, there are no laboratory experiments to prove the underlying suppositions of psychotherapy to be true, but many individuals, going back to World War I shell-shock victims, say that it has helped them. Undoubtedly, there is a lot of hype and even fraud in psychotherapy—demonstrated, for example, by efforts to rehabilitate violent criminals, which have had some tragic results. Nevertheless, the author's broad-brush dismissal seems unwarranted.

His attacks on other instances of false knowledge, however, are well warranted. He treats the reader to a penetrating analysis of multiculturalism, demonstrating that it is not about respecting differences or the diversity of ethnic groups in America, as its apologists claim. It is instead "a melodramatic tale of the wickedness of the West and its role in destroying the peaceful paradises in which other people (usually 'of color') lived before Europeans and then Americans came along to inflict racism, sexism, slavery, colonialism, imperialism, homophobia, technology, and environmental degradation."

Another venerable bit of false knowledge that comes in for Thornton's withering scrutiny is the idea that American Indians were ethical paragons. We have put Indian culture on a pedestal. Thornton knocks it back off, showing that Indians could be wasteful despoilers of the environment to the limited extent that their technology permitted and that their treatment of other human beings was often repulsively brutal.

Plagues of the Mind provides a much-needed explanation of why, despite increasing levels of formal education, people are more and more apt to give credence to fallacious ideas and claims. In addition, it makes the important point that, while civilizations have always been plagued by epidemics of false knowledge, the spread of false ideas at this time in history is more dangerous "not just because high-tech media multiply exponentially the mischief that falsehood can work, but also because we are a democracy and democracy cannot thrive without a certain diet of truth."

Overall, *Plagues of the Mind* is a worthwhile book that warns of a spreading disease

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that medical science cannot treat—the inability to think clearly. □

Charles Stampul writes "On Principle" (on_principle @excite.com), a column offering philosophical and moral guidance to young adults.

American Compact: James Madison and the Problem of Founding

by Gary Rosen

University Press of Kansas • 1999 • 237 pages • $29.95

Reviewed by David Upham

At the time of independence, virtually all Americans believed, with the authors of the Declaration of Independence, that government derives its "just powers from the consent of the governed." Yet the principle of popular sovereignty does not indicate how a people can be organized so that they may exercise their right to establish new government. A people cannot spontaneously assemble and adopt a plan of government. Some individual or group must first assume the authority of submitting a formal proposal before the people. In light of the principle of popular sovereignty, then, on what basis can this proposing authority be justified?

That theoretical difficulty was faced by the constitutional convention that met in 1787. One of the main objections leveled against the convention was that, in proposing the Constitution, it had acted without popular authorization. In effect, while the established popular government in Congress had directed the convention to propose revisions to the existing national constitution, the Articles of Confederation, the convention recommended a complete abolition of the Articles and the adoption of an entirely new constitution.

According to Gary Rosen, managing editor of *Commentary,* James Madison met those objections by setting forth a theory of popular government that substantially modified the prevailing social contract theories. While previous contractarians had assumed that a people in their pre-political state had the capacity to institute government on their own, Madison argued that the establishment of government requires an initially aristocratic action: namely, a proposal made by a small number of individuals who possessed those virtues (especially prudence) necessary for good deliberation.

Rosen notes that unlike the multitude, these few "were capable of arriving at an independent view of the Constitution that was based on something more than the exigencies of the moment." Consequently, they could "do for the people what [the people] could not do for themselves." Madison argued that the Philadelphia convention had served this vital purpose. In this way, Rosen says, Madison introduced into modern social compact theory a feature of classical political philosophy; for the justification of the framers' right to propose, like that of the right to rule in classical thought, was derived not from the will of the many, but from the superior virtue of the few.

At the same time, Rosen notes, Madison remained a committed republican. He believed that no individual or group was so virtuous that it should be entrusted with the interests and rights of a people without being regularly accountable before this same people. Moreover, he held that both the people's expectations and their spirited desire for rule had to be accommodated. In fact, this spiritedness, if rightly directed, would benefit the endurance of good government. Through their ratification of the Constitution, the people would understand the government as a work of their own making and would consequently possess, in Rosen's words, "[a] constitutional passion, an unthinking attachment to the Constitution as an end in itself."

According to Rosen, it was Madison's understanding of the Constitution, "an understanding that gave proper attention to both the prudence of the founders and the claims of the people," that explains his subsequent disagreements with Jefferson and Hamilton. Jefferson, the strict majoritarian, proposed that new constitutional conventions be held at least every 19 years. Madison argued that such conventions would both undermine the popular reverence for the Constitution and would be unlikely to enjoy the degree of prudence manifest in the 1787 convention. At the same time, Madi-

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son opposed Hamilton's "loose construction" of the Constitution, according to which the federal government could assume any general power of sovereignty without reference to a specific power granted by the Constitution. Madison held that such an interpretation actually did violence to the people's will as expressed through their ratification of a written charter. The federal government could not rightly exercise any power unless it were granted to them by the people, either formally, through a constitutional amendment, or informally, through a popularly endorsed precedent. It was for this reason that Madison initially opposed as unconstitutional the establishment of a national bank, but later signed into law the second charter of the same bank while president, for the bank had been repeatedly approved by the people's representatives in Congress.

There are two major weaknesses in Rosen's analysis. On the one hand, he overestimates the degree to which Madison's compact theory was influenced by that of Thomas Hobbes. Contrary to Rosen's claim, Madison did not share Hobbes's understanding of the "law of nature" as a law of physical rather than moral necessity. On the other hand, Rosen suggests that Madison located prudence in the republic solely in the constitutional convention. Yet Madison surely expected the prudence of both the people and their elected representatives to play an enduring and vital role in the new republic.

Despite these difficulties, Rosen successfully demonstrates that Madison deserves to be studied as a political theorist and vindicates Madison against the prevailing view that he was a man of inconstant principle. Rosen's analysis is lucid and thoughtful. This book merits serious attention. □

David Upham is a doctoral student in politics at the University of Dallas.

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IDEAS ON LIBERTY
SEPTEMBER 2000

Will Campaign Finance Reform Enhance the Power of the People?

A common cry among the reform set these days is that there is too much money in politics. Those who decry the role of money in politics imagine a world where the 535 members of Congress along with the president sit around in togas discussing the best way to serve the people. Rather than being influenced by money or special interests, these modern-day Platos and Aristotles would be motivated by the public good.

To achieve that utopia, some would ban soft money, the money that can be donated in unlimited amounts to the political parties. This may violate the First Amendment. But ignoring constitutional issues, can reform enhance or reduce the power of the people?

Getting the money out of politics is a little like trying to take the grinder out of the sausage factory. The federal government currently spends about $1.7 trillion annually. With that much money up for grabs, it's awfully hard to stop people from trying to influence how it's spent. It's only a question of how that influence will manifest itself. Will it be out in the open or hidden?

If you want to see the effect of a ban on soft money, consider the following fable. Once upon a time, there were only two manufacturers of cars, Ford and GM, but cars could only be marketed and sold in a very unusual way. Each manufacturer was allowed to nominate one car that it would manufacture and sell for the next four years. While there were two manufacturers, only one was chosen to actually produce and sell the car. A vote of the people determined the producer. To let the voters and consumers make an informed choice, the car manufacturers took the cars on tour. Unfortunately, voters couldn't drive the cars, so the people turned to various other ways for information about the candidates. I mean, cars. For example, they watched the advertising campaigns of the manufacturers. In those campaigns, GM knocked Ford's product and vice versa, but that was often informative. People also relied on information from the media—the writers, reporters, and talk show hosts who covered the car industry and had specialized knowledge of the products.

Choosing the Familiar

In this weird car market the two manufacturers picked their cars carefully. They chose cars familiar to the voters because the voters already knew something about their quality. Sometimes, a manufacturer would introduce a radical new concept, a minivan or a convertible. For these new models to have a chance, a lot of money would have to be spent advertising the product to get voters acquainted with it.

Even rarer than a new product from GM and Ford was a new party—oops, manufacturer. On rare occasions, one would come along and try to get the voters to take a chance on a new offering. They were hesitant to take a chance on an untested brand. But if the

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product was good enough and sufficient money was spent to inform the voters, a new manufacturer could succeed from time to time.

One day, people decided that the companies were spending too much money advertising their cars. Why not limit the total amount they could spend? Less money would be wasted on advertising, and there would be less influence by special interests, the families always lobbying for minivans and the young folks pushing for convertibles. A law was passed to radically limit the amount of advertising. To make up for the lost advertising, debates were held, where representatives from GM and Ford stood in front of their nominated cars and argued over their relative merits.

With limits on advertising, brand names became even more important. A new manufacturer found it almost impossible to introduce a new model. Without the ability to use a substantial advertising budget to overcome the brand-name advantage of incumbent cars, even high-quality products were unable to get a foothold in the market. They were rarely invited to the debates. After all, explained the organizers, those no-name cars don't really have a chance. So the two major manufacturers became even more powerful.

Incumbent cars became difficult to defeat. Ford and GM usually nominated the same cars over and over again because they were familiar to voters. Innovation in the industry came to a standstill. Why would Ford and GM improve their cars? Such improvements came at a cost. To let voters know about the quality of the new product required advertising that was no longer possible.

Defenders of the limits on advertising found the greatest solace in what appeared to be the reduction in the power of special interests. But special interests found new ways to influence the process. Because these methods were now behind the scenes, they were harder to detect. Special interests befriended people at Ford and GM to influence which cars were put forward. They took reporters and TV anchormen to dinner to tell them the virtues of their favorite cars. They placed people sympathetic to their outlook on the car company payroll and on newspaper staffs. They befriended talk show hosts. In this way they insured sympathetic treatment of their views without looking heavy-handed.

But few noticed the corruption. And while some complained that the cars seemed to get duller and duller every year, few attributed this to the limits on advertising. Instead people looked for new reforms and regulations to reduce the role of money even further. They didn't realize that each step in that direction made the market less competitive.

Most reforms of the political marketplace are taking us in the same direction. While they appear to enhance the power of the people relative to the special interests, they do so by reducing competition, the consumer's and voter's best friend.

With less competition, the biggest beneficiaries of a ban on soft money will be incumbents. They will find it easier to use their already powerful brand-name recognition to overcome challengers who can no longer expect party money to help them establish their name and ideas.

Ironically, the best way to reduce the power of special interests is to allow hard money to flow without limitations—remove the limits on how much individuals and organizations can give directly to candidates. This would expand the field of potential candidates.

The ultimate arbiter is always the ballot box. Unlimited hard money allows voters to have more choices. Promptly post all contributions on the Internet. Candidates who are in the pocket of special interests can be reviled by the media and then by the voters. When the government spends almost $2 trillion and writes myriad regulations, keeping the political marketplace competitive remains our best hope for enhancing the power of the people. □

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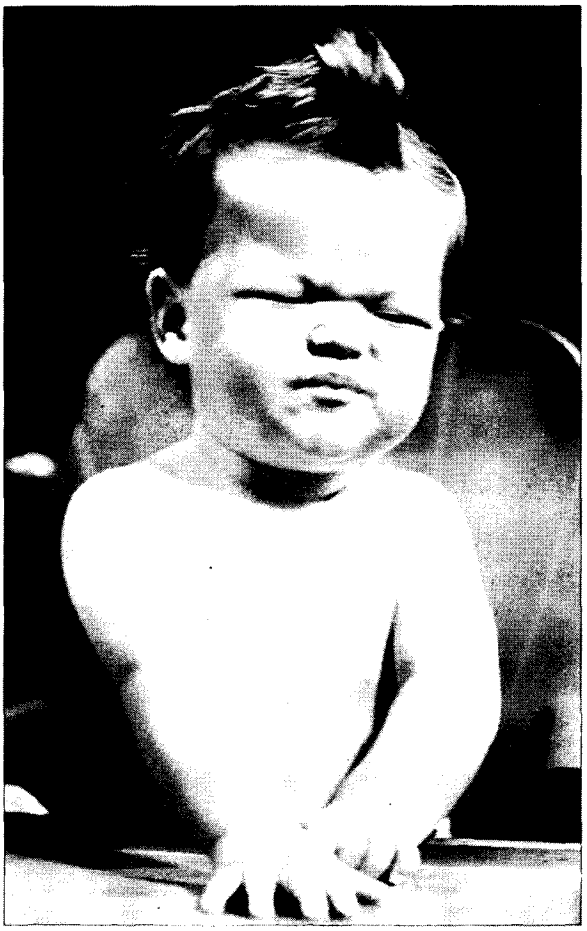

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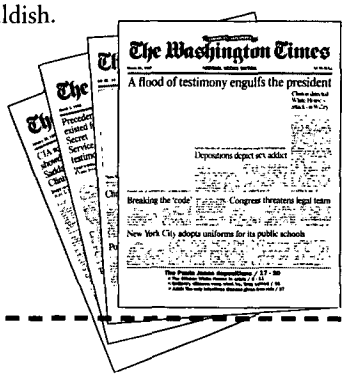
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